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The State of Internet Radio in 2010

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https://scholarship.shu.edu/student_scholarship/35

DATE SUBMITTED: MAY 1, 2010

This paper is submitted in satisfaction of the Seton Hall Law School's Advanced Writing Requirement.
This paper is approved for AWR certification. E. Judson Jennings, Professor of Law

The State of Internet Radio in 2010

AWR & Independent
Study

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The State of Internet Radio in 2010

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1. Introduction

Copyright law as it relates to music is complex and often confusing. Historical influences embodied within the United States Copyright Code can be traced as far back as Ancient Greece.¹ Today, copyright law in the United States provides the owners of musical compositions and sound recordings with a sophisticated web of rights that can be lucrative when utilized effectively. This bundle of rights that accompanies original works of music has grown in reaction to new technologies of media distribution and publication. Technological advances ranging from the printing press to the player piano, to the compact-disk have influenced the ways in which music is disseminated and consumed. Since 1790, the United States Congress has used positive law to reward copyright owners by expanding the exclusive rights vested in copyrights in ways that have increased the bargaining power of copyright owners each time new technologies affecting distribution of intellectual property are developed. The trend of expanding copyright law has intensified in recent years. Between 1975 and 2000, the Copyright code grew at an annual rate of 6.9%, ballooning from 22,310 words to an astounding 124,320 words.²

The most recent technological advance resulting in an expansion of rights for music copyright owners is the internet. Arguably, the internet is the most important and influential broadcast pipeline in music history. It surpasses terrestrial radio as the most efficient and personalized transport mechanism for music because the internet facilitates traditional non-interactive broadcasts, as well as interactive broadcasts, and direct purchases of music. The internet allows music consumers to try music before purchasing it without leaving their homes.

¹ Michael W. Carrol *Whose Music is it anyway?: How we came to view musical expression as a form of property*, 72 U. Cin. L. Rev. 1405, 1420 (2004).

² William M. Landes and Richard A. Posner, *THE POLITICAL ECONOMY OF INTELLECTUAL PROPERTY LAW* 2 (The AEI Press 2004).

During the fall of 2009, Ford Motor Company introduced the first internet console for the automobile.³ Internet radio can be streamed to iPhones and Blackberry smart phones.⁴ This is a sign that internet radio is migrating from the personal computer to more mobile devices, using cloud computing⁵ and other technologies to make the dream of a celestial jukebox a reality.⁶

Historically, governments have enacted legislation to expand the rights of copyright owners after an infringing technology has existed long enough to understand how to narrowly tailor legislation to address and solve only the existing problems with the infringing danger. Legislation addressing the infringing dangers of the internet on music compositions and sound recordings, however, was enacted before the problems could be adequately understood and before the recording industry could make simple adjustments to their business models to mitigate dangers posed by the internet and other digital technologies.⁷ The result has been a culture war pitting old technologies against new, producing a system of disparaging law that unfairly and unwisely discriminates against music based internet technologies. It did not have to be this way. Throughout the early and mid 1990's, a handful of music industry insiders urged executives to adjust business goals to gain a market share in the coming digital world.⁸ Blinded by short term profits earned during the heyday of the compact-disc, executives chose to cling to their business model and fight making the inevitable transition to superior digital formats.⁹

³ Ashlee Vance and Matt Richtel, *Despite Risks, Internet Creeps Onto Car Dashboards*, New York Times, January 6, 2010. Available at <http://www.nytimes.com/2010/01/07/technology/07distracted.html>

⁴ Meg Tirrell *Pandora Media Founder Sees Company's First Profit Next Year*, Bloomberg, May 19, 2009. available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aaKvHKT2hji0>.

⁵ *Let it Rise*, The Economist, October 25, 2008 (explaining the concept of "cloud computing" as making digital content accessible from anywhere, rather than a single hard-drive device).

⁶ Charles C. Mann, *The Heavenly Jukebox*, September 2009, <http://www.theatlantic.com/issues/2009/09/mann.htm>.

⁷ Larry Lessig, *FREE CULTURE; THE NATURE AND FUTURE OF CREATIVITY* 297-298 (Penguin Books 2004).

⁸ Seth Mnookin, *Universal's CEO Once Called iPod Users Thieves. Now He's Giving Songs Away*, Wired Magazine, Nov. 27, 2007.

⁹ *Id.*

The following pages analyze the history and current state of disparity in laws that have stifled the growth of internet radio technologies. Internet radio has the potential to be the most revolutionary technology to aid composers of music and sound recording artists in publishing, distributing, and popularizing their music. This paper begins by looking at the history of how music gained property rights and developed copyright protection. Within this history, a complicated system of interests in various income streams associated with music are explained. The second section looks at the history of terrestrial radio and its influence on copyright law. In the third part, the paper outlines the various formats of internet radio and looks at the myriad of laws effecting internet music technologies. The discussion begins by looking at the Digital Performance Rights in Sound Recording Act of 1995 and extends to current royalty rates and per station fees imposed on internet radio. Next, the paper explores many of the benefits and challenges facing internet radio businesses and the ways in which these internet companies have worked to form a community of support. The paper concludes by briefly offering proposals for future legislation and future business models that can help internet radio and the recording industry coexist. Working with the current framework of copyright law, it is possible to foster growth in internet radio while enabling musicians and recording companies to generate fair revenues.

I. Overview of Copyrights in Sound Recordings

Music has long been treated as a form of property. Determining the rights that should be associated with music ownership is difficult for several reasons. The initial obstacle is simply defining “music.” Music is a reflection of cultural norms, and consists of sounds that are designated as “music” rather than “noise.”¹⁰ Defining music for the purposes of law requires imposition of rules and order, together with forms of notation, recording, or other documentation to preserve music so it may be reproduced.¹¹ Technology has always been the driving force behind the evolution of the music business. It influences the ways in which music is memorialized, produced, reproduced, disseminated, consumed, and therefore defined. Over the course of several centuries, the rights vested in music compositions and recordings have increased, so as to resemble those characteristics associated with real estate and other more tangible properties.¹² Legislators and courts have recognized more rights in music in reaction to developments in technology that have increased the ease of preserving music in the form envisioned by content creators.

Law professor Michael Carrol defines the three conditions of music being treated as property as “(1) those associated with the production or distribution claim a proprietary relationship with music; (2) those who make proprietary claims also claim a right to receive attribution in connection with the music or to prohibit or control the reproduction, distribution, or performance of ‘their’ music by others; and (3) these claims of control are recognized and vindicated by law.”¹³ Music had a long road to travel before it could be claimed and treated as

¹⁰ Carrol, *supra* note 1, at 1416.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 1418.

property. Among the chief advances necessary was developing a system of documenting original musical works in written form.

A. Music as Property, a Historical Perspective

Musical notation existed at least as far back as the fourth century B.C.E. in Ancient Greece.¹⁴ Music notation during this period was descriptive in nature, meaning that notes were described in relation to one another but pitch and tempo were determined by the performer rather than the composer.¹⁵ Descriptive music notation increased the likelihood that no two musical performances would be identical. It was not until the middle ages, nearly 1,000 years later, that notation was refined through institutionalization of the church.¹⁶

Under Pope Gregory I (590-604), the Church established an official catalog of songs to be used as the exclusive music of the Christian Church.¹⁷ It was during this time that music notation began to change from being descriptive in nature to being prescriptive. In an effort to standardize and regulate music used for church activity, pitch became defined and notated in written scores.¹⁸ Later, during the eleventh century, the modern staff notation for writing music was developed. The modern staff continued to evolve through the thirteenth century, at which time tempo and note length were first written.¹⁹ Contemporaneous to these developments was the growth of the medieval city and performing arts guilds. Cities began to treat labor and music as a commodity by granting performance guilds the exclusive right to perform music at public gatherings.²⁰ Until the advent of the printing press, performance of music remained more highly

¹⁴ *Id.* at 1420.

¹⁵ *Id.*

¹⁶ *Id.* at 1433.

¹⁷ *Id.* at 1440.

¹⁸ *Id.* at 1441.

¹⁹ *Id.* at 1441-1442.

²⁰ *Id.* at 1447.

regarded than music composition and it was common for composers not to claim ownership or sign their names to original works.²¹

Perhaps the greatest invention for the evolution of modern society occurred in 1451, when Gutenberg invented the movable type printing press.²² The Guttenberg printing press made reproduction and distribution of printable works economically viable, while triggering a significant expansion in the number of people who became literate. Increases in literacy rates and accessibility to printed music produced a growing class of professional and leisure musicians who consumed sheet music.²³ New businesses developed to pursue new market opportunities. In 1501, Ottaviano de' Petrucci of Venice became the most prominent music publisher, proving that a market existed for the sale of sheet music.²⁴ In the years leading up to and following the rise of Ottaviano de' Petrucci's publishing business, governments throughout Europe began issuing exclusive publishing rights to printers in order to incentivize investment in publishing businesses and technologies.²⁵ Publishers controlled access and bargaining power over the dissemination of works. Composers would often be commissioned to write works through indentured relationships with wealthy patrons.²⁶ In exchange for their financial support, financiers of written works would often receive a dedication, authorship credit, or title to the finished work.²⁷

Over time, persons associated with the production or distribution of music compositions began seeking authorship and ownership attribution.²⁸ Publishers contracted to hold an exclusive

²¹ *Id.* at 1440.

²² Al Kohn & Bob Kohn KOHN ON MUSIC LICENSING 3rd ED. 619 (Aspen Law & Business 2002).

²³ Carrol, *supra* note 1, at 1460.

²⁴ Kohn & Kohn, *supra* note 22, at 619.

²⁵ Carrol, *supra* note 1, at 1460.

²⁶ Note, *Exploitative Publishers, Untrustworthy Systems, and The Dream of a Digital Revolution For Artists*, 114 Harv. L. Rev. 2438 (2001).

²⁷ *Id.*

²⁸ Carrol, *supra* note 1, at 1460.

right to publish the musical composition in a geographical region, and the financier was typically the sole beneficiary of royalties from the sale of printed compositions.²⁹ By encouraging growth and investment in new technologies, European governments achieved a societal goal of fostering new creative arts. The increased ease of publication brought about Professor Carol's second stage of music being treated as property. Those with authorship and ownership claims over original works were now seeking control over the subsequent printing, distribution, and income derived from such works.³⁰

Copyright law in the United States of America draws direct lineage from England. In 1662, the British Kingdom first began issuing formal copyrights under the Licensing Act.³¹ Copyright law grew out of the publishing industry. Technological innovation influenced change in business models, which led to new law intended to foster business and technology. The Licensing Act utilized the growing market for title in written works by granting publishers the exclusive right to print certain works.³² This statute was later replaced in 1710 by the Statute of Anne, which granted publishers a 14 year term of copyright exclusivity.³³ The Statute of Anne is viewed by many as the primary influence on copyright law in America. The statute enabled musical composition authors and owners the right to control attribution, reproduction, and transferability of original printable works.³⁴ Publishers began purchasing copyrights from authors, entitling publishers to be the sole beneficiary of profits obtained through the exploitation and sale of an author's work.³⁵ As the first significant copyright statute, The Statute of Anne was narrow in scope, and sought to afford rights to offset risks of injury being caused at that time

²⁹ *Id.* at 1470.

³⁰ *Id.* at 1418.

³¹ Lessig, *supra* note 7, at 86.

³² Note, *supra* note 26, at 2439.

³³ Lessig, *supra* note 7, at 86.

³⁴ *Id.*

³⁵ *Id.* at 85-90.

by new technologies.³⁶ The statute was narrowly tailored and limited to the right to use a specific machine to replicate a specific work.³⁷

In the United States, the power of Congress to enact copyright law is secured in Article I Section 8 of the Constitution.³⁸ In 1790, Congress first exercised this power by creating a secured renewable 14 year copyright.³⁹ During the first hundred years of America's existence there were hardly any significant technological advances nor copyright amendments having effect on the rights of music owners. Between 1451 and the late 1880's composers transitioned to claim authorship credit and derive income for their works through the sale of sheet music.⁴⁰ Public performance by local and touring musicians remained the primary vehicle for popularizing and advertising music. The advent of the player piano in the 1880's revolutionized the way music was performed and consumed in public, and became the first musical technology advance in American history to trigger an amendment to the copyright code.

The player piano offered the first income producing means to record and reproduce a song.⁴¹ A player piano is a piano equipped with a mechanical component that uses air pressure to play a piano's keys as dictated by depressions in a printed piano roll.⁴² Pubs and restaurants began purchasing player pianos as a relatively inexpensive way to reproduce perfectly performed music that was familiar to patrons. Use of player pianos increased the sale of sheet music and helped to promote a culture of popular music by reproducing familiar songs with perfect consistency. After gaining notoriety from being performed publicly by live musicians as well as player pianos, "After the ball" by Charles K. Harris became the first song to sell one million

³⁶ *Id.*

³⁷ *Id.* at 87.

³⁸ U.S. Const. art. I, § 8.

³⁹ Lessig, *supra* note 7, at 133.

⁴⁰ Mathew S. DelNero, *Music: Long Overdue?: An Exploration of the Status and Merit of a General Public Performance Right in Sound Recordings* 6 Vand J. Ent. L. & Prac. 181, 183 (2004).

⁴¹ *Id.*

⁴² Kohn & Kohn, *supra* note 22, at 682.

copies of sheet music in 1893.⁴³ In 1902 there were approximately 75,000 player pianos and 1.5 million perforated music rolls in use in the United States.⁴⁴

Under early American copyright law, composers held the exclusive right to reproduce original sheet music. For music composition owners, there existed an open question of law as to whether the reproduction of piano rolls invoked the copyright holder's exclusive right to reproduce printed music. In 1908, the Supreme Court distinguished a composition owner's exclusive right to reproduce original written music from the act of reproducing audio renditions of their original music.⁴⁵ In White-Smith Music Publishing Company v. Apollo Company, the court determined that the copyright code granted composers the exclusive right to reproduce original sheet music, but did not protect audio reproductions of compositions. Justice Day wrote "these musical tones are not a copy which appeals to the eye."⁴⁶ The court created a distinction between copyright protection based upon which of the five senses a work of music directly appealed to. This distinction separating mechanical and sheet music reproductions did not last long. White-Smith Music Publishing Company v. Apollo Company remains a historically significant case because it established that rights in sound recordings do not necessarily mimic those rights held in printed transcripts of original works.

Within a year of the Supreme Court's decision, Congress legislated to overrule the Supreme Court by explicitly granting copyright owners of sheet music the exclusive right to make mechanical reproductions of their songs.⁴⁷ Contemporaneous to the granting of an exclusive mechanical reproduction right, Congress provided a compulsory mechanical license

⁴³ Kohn & Kohn, *supra* note 22, at 620.

⁴⁴ White-Smith Music Publishing Company v. Apollo Company 209 U.S. 1, 9 (1908)

⁴⁵ *Id.*

⁴⁶ *Id.* at 17.

⁴⁷ Kohn & Kohn, *supra* note 22, at 682.

for manufacturers of piano rolls and other mechanical music playing devices.⁴⁸ The compulsory license provided a creative mechanism to combat a near monopoly held by the piano roll producer The Aeolian Co. In the early 1900's, The Aeolian Co. held an abundance of exclusive contracts with music publishers for the right to make mechanical reproductions of their works.⁴⁹ The copyright office, empowered by Congress, would set a statutory royalty rate paid to composition copyright holders for each reproduction of their works. A compulsory mechanical license remains in existence today and is codified under § 115 and § 801 of the copyright code.⁵⁰ As with the relationship between publishing and early copyright law, the player piano provides another example of how technological innovation influenced change in business models, which led to new law intended to foster the interaction of business and technology.

Modern American copyright law divides the copyrights of a musical work into two distinct parts. There are distinct rights held in the composition of a song and distinct rights held in the sound recording of a song.⁵¹ Often times the sound recording copyright is owned by a different party than the composition copyright.⁵² Composition copyright owners entitled to mechanical license royalties typically contract with a music publishing company to administer their publishing rights.⁵³ Publishers regularly receive 50% of mechanical license royalties in exchange for administering the publishing rights of a song.⁵⁴ The mechanical license for non digital music reproductions is administered by the government affiliated Harry Fox Agency.⁵⁵ The Copyright Office periodically increases the rate that must be paid per song for the

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ 17 U.S.C. § 115 (1976). 17 U.S.C. § 801 (1976).

⁵¹ Shane Wagman, *Changing Face of Copyright Law* 17 J. Intell. Prop. L. 95, 100 (2009).

⁵² Donald Passman, *ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS* 218 (Free Press 7th ed. 2009).

⁵³ *Id.* at 221.

⁵⁴ Andrey Spector, *How Chorus can Turn Into a Cacophony: The Record Industry's Stranglehold on the Future of Music Business* 16 Rich. J. L. & Tech. 3, 20 (2009).

⁵⁵ *Id.*

mechanical license. In 1976 the rate was 2.75 cents per song, the most recent rate was set at 9.1 cents per song in 2008.⁵⁶ Royalties resulting from digital sales and performances of music are collected by SoundExchange, an independent organization originally founded by the Recording Industry Association of America (RIAA) and currently representing more than 3,500 record companies.⁵⁷

The bundle of rights held by composition copyright owners was growing rapidly in the years surrounding the start of the twentieth century. Since 1887, composition copyright owners held the exclusive right to public performance of their works.⁵⁸ After the 1909 amendment, copyright holders were entitled to a royalty for the reproduction and sale of their sheet music or mechanical musical reproduction tool, and for the public performance of music played by machine or person.⁵⁹ Composers nonetheless faced a dilemma, while congress provided copyright owners with an easy way to collect mechanical copyrights, enforcing the public performance right had been far more difficult but represented a large untapped form of income.

B. Performing Rights Organizations; the PRO's

According to legend, a group of lawyers and composers including Victor Herbert, Irving Berlin, and John Philip Sousa were eating dinner at The Lambs restaurant in New York City when they began discussing the need for an efficient means to enforce their exclusive right to public performance of musical compositions.⁶⁰ Collectively these songwriters have made some of the most significant contributions to American music, including the songs “White Christmas,”

⁵⁶ *Id.*

⁵⁷ SoundExchange Frequently Asked Questions, <http://soundexchange.com/category/faq/#question-428> (last visited April 6, 2010).

⁵⁸ Kohn & Kohn, *supra* note 22, at 904.

⁵⁹ *Id.* at 682.

⁶⁰ *Id.* at 903.

“God Bless America,” “Semper Fidelis,” and “Stars and Stripes Forever.” The group discussed the two main reasons composers failed to enforce their exclusive right to public performance of their compositions for the first fifteen years the right existed. First, it was widely believed that public performance was the key to driving sales of sheet music.⁶¹ Sheet music had long been the most reliable form of songwriter income, and songwriters had learned to be dependent upon the regime that had long been in place.⁶² The second reason the right had not been enforced was the impracticality of thousands of individual copyright owners attempting to collect public performance royalties from thousands of nightclubs and community music venues. This dinner meeting concluded with the formation of the first collective performance arts organization, “intended to prevent the playing of all copyrighted music at any public function unless a royalty was paid.”⁶³

Under the current § 106 of the Copyright Act, composers have the exclusive right to perform and authorize others to perform their works publicly.⁶⁴ Born out of the ambition of composers, the American Society of Composers, Authors, and Publishers (ASCAP) became the model performance rights organization (PRO) and established the business model used to enforce § 106 of the Copyright Act. Beginning in 1922, ASCAP started collecting a \$250 licensing fee from radio stations on behalf of composers whose music was being broadcast.⁶⁵ Until 1940, ASCAP held a monopoly as the sole enforcer of public performance rights.⁶⁶ Broadcast Music Incorporated (BMI) formed in December of 1940 in anticipation of failed

⁶¹ Mathew S. Del Nero, *Music: Long Overdue?: An Exploration of the Status and Merit of a General Public Performance Right in Sound Recordings*, 6 Vand. J. Ent. L. & Prac. 181, 183 (2004).

⁶² *Id.*

⁶³ Russell Sanjek & David Sanjek, *PENNIES FROM HEAVEN* xv (Da Capo Press 1996) (citing *Trust for Control of Music Business: ASCAP Organized at Meeting Here*, N.Y. TIMES, Feb. 14, 1914).

⁶⁴ 17 U.S.C. § 106 (1976).

⁶⁵ Allison Kidd *Recent Development: Mending the Tear in the Internet Radio Community: A Call for a legislative Band-Aid* 4 N.C. J.L. & Tech. 339, 346 (2003).

⁶⁶ Kohn & Kohn, *supra* note 22, at 907.

licensing negotiations between ASCAP and radio broadcasters.⁶⁷ When broadcasters refused to pay increased licensing fees demanded by ASCAP for the right to broadcast music in their catalogue, BMI stepped in offering a new catalogue of less well known music for a more reasonable licensing rate.⁶⁸ Beginning in January 1941, BMI struck several licensing deals as a replacement option for those broadcasters who could not reach agreement with ASCAP.⁶⁹

Today ASCAP coexists with BMI and the Society of European Stage Authors & Composers (SESAC) as the three PRO's that collect public performance royalties on behalf of composition owners each time their works are performed publicly in the United States.⁷⁰ The influence of these organizations is widely felt throughout the music industry because the composers, their music publishers, and broadcasters of music must do business with the PROs in order to fulfill their goal of enforcing their exclusive right in public performance afforded under the Copyright code.⁷¹ Upon joining a performance rights organization, the songwriter transfers the nonexclusive right to license non-dramatic public performances of its songs to the organization.⁷² PRO's assume three primary responsibilities (1) Issuance of licenses and the collection of licensing fees, (2) monitoring of public performances of music, (3) paying songwriters and publishers based upon the number of times their music is performed publicly.⁷³

The reach of § 110 of the Copyright Act is very broad.⁷⁴ To perform music publicly is to (1) “perform... it at a place open to the public or at any place where a substantial number of persons outside of a normal circle of family and its social acquaintances is gathered” or (2) “to

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ Jonathan Cardi, *Uber-Middleman: Reshaping the Broken Landscape of Music Copyright* 92 Iowa L. Rev. 835, 839 (2007).

⁷¹ David J. Moser, MUSIC COPYRIGHT FOR THE NEW MILLENIUM 76-79 (Artistpro, 2001).

⁷² *Id.*

⁷³ *Id.*

⁷⁴ 17 U.S.C. § 110 (1976).

transmit or otherwise communicate a performance... of the work to a place specified by clause or to the public, by means of any device or process, whether the members of the public capable of receiving the performance receive it in the same place or in separate places at the same or different times.”⁷⁵

The public performance right granted to composers applies to four categories of public performance. (1) Anytime a work is performed in a public location, including all places where the general public is free to access regardless of how many people are present and regardless of whether an admission fee is charged to be at the location. (2) Any time a work is performed at a location where a “substantial” number of people other than family and friends are gathered. (3) Anytime a work is transmitted to a public place by a device enabling images or sound to be received beyond the original broadcasting location. (4) Anytime a work is transmitted by a device with the potential to be received and viewed or listened to, regardless of whether the public receives the broadcast transmission is actually received and consumed.⁷⁶ Currently, the three PROs collect more than \$1 billion in performance royalties on an annual basis.⁷⁷ Most commonly, broadcasters of music are issued blanket licenses on an annual basis, giving the licensee the right to publicly perform any music in the PROs catalog an unlimited number of times.⁷⁸ The rate paid for a blanket license varies depending on the type of business and type of broadcast. Radio stations and television stations pay more for the right to broadcast music than do bars and shopping outlets. Radio and television outlets typically pay 2% of their adjusted gross receipts to obtain a blanket license, while most other business are charged a flat fee

⁷⁵ Kohn & Kohn, *supra* note 22, at 909.

⁷⁶ Moser, *supra* note 71, at 76-79.

⁷⁷ Del Nero, *supra* note 61, at 184.

⁷⁸ Moser, *supra* note 71, at 76-79.

negotiated in advance.⁷⁹ Each PRO uses its own formula to assign a value or weight to different performances.⁸⁰ Factors considered when royalties are paid include the size of a potential audience, the time of day a performance occurs, and the type of performance broadcast.⁸¹ Composers and publishers are then paid royalties based upon the number of performances and the weighted value accorded to each performance. ASCAP and BMI are registered not for profit organizations, while SESAC is a for profit corporation.⁸² The two not for profit PROs typically distribute 80-85% of licensing fees collected annually to their composers, while SESAC distributes 50-60% of licensing fees to its artists.⁸³ When fees are distributed by the PROs, 50% is paid to the composer and 50% is paid to the music publisher the composer has contracted with.⁸⁴

C. Record Companies

Record companies primarily serve the function of financing, promoting, and distributing music recordings. In a typical recording contract, an artist transfers the copyright in their sound recordings to a record company in exchange for an advance sum of money that is used to finance the recording process and living expenses of the artist.⁸⁵ An artist will often receive between thirteen and twenty percentage “points” as a royalty from the sale of its music.⁸⁶ Before receiving any royalty income on the sale of music, the entire advance must be recouped through album sales.⁸⁷ Unlike a typical loan arrangement where the debtor retains the value of their investment once it is paid off (i.e. house, education), the record company stands to earn back its

⁷⁹ Cardi, *supra* note 70, at 846.

⁸⁰ Moser, *supra* note 71, at 76-79.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ Cardi, *supra* note 70, at 845.

⁸⁵ Passman, *supra* note 52, at 86.

⁸⁶ *Id.*

⁸⁷ Jacob Slichter, *SO YOU WANNA BE A ROCK & ROLL STAR* 49 (Broadway 2004).

invested advance and retain ownership of a band's work product as well as 80-87% of future income derived from that band's sound recordings.⁸⁸

Record labels take significant risk when investing in new artists. In addition to paying an artist's advance, it is common for record labels to fund promotional costs behind a single album that include investments in the range of \$50,000 for print advertisements, \$400,000 for radio promotion, and \$600,000-\$1,000,000 to produce a music video.⁸⁹ Income derived by record companies comes from the exploitation of sound recording copyrights, primarily through the sale of records. In the past, record companies have benefited from periodic technological advances that lead to a change in the format consumers used to listen to music.⁹⁰ Millions of people have purchased albums by bands such as Pink Floyd and the Beatles on vinyl, cassette tape, and CD. Since the advent of the MP3 and the technology enabling CD owners to convert audio files to MP3 files, the need for repeat purchases has been abolished.⁹¹ Since 1999 the four major music recording labels Sony-BMG, EMI, Warner Music Group, and Universal Music Group have experienced significant declines in revenue. It is suggested by many that decreases in revenue have resulted from the failure of these industry leading labels to adjust their business models to operate efficiently in the digital age.⁹²

Record companies used to have more control over their business model. Companies used legal, illegal, and grey area tactics to exercise substantial influence over music played on American radio.⁹³ Radio served the purpose of advertising for the sale of sound recordings,

⁸⁸ Passman, *supra* note 52, at 86.

⁸⁹ Revella Cook, *The Impact of Digital Distribution on the Duration of Recording Contracts*, 6 Vand. J. Ent. L. & Prac. 40, 46 (2003).

⁹⁰ William Patry, *MORAL PANICS AND THE COPYRIGHT WARS* 3(Oxford University Press 2009).

⁹¹ *Id.*

⁹² Steve Knopper, *APPETITE FOR SELF-DESTRUCTION: THE SPECTACULAR CRASH OF THE RECORD INDUSTRY IN THE DIGITAL AGE* (Free Press 2009). *See also* Bennet Lincoff, *Common Sense, Accomodation and Sound Policy for the Digital Music Marketplace*, J. Int'l Media & Entertainment Law, Vol. 2, No. 1, at 5 (2008).

⁹³ Fredric Dannen, *HIT MEN: POWER BROKERS AND FAST MONEY INSIDE THE MUSIC BUSINESS* (Vintage, 1991).

which in turn created record company profits.⁹⁴ Prior to the sale of MP3's over the internet, recording companies acted as gatekeepers with the power to control what music was available in America's record stores.⁹⁵ During a five year period in the 1990's, record companies inflated their revenue by pressuring retail stores to raise the price of the typical CD from \$13.95 to \$18.⁹⁶ In February 2008, Apple Inc.'s iTunes became the largest music retailer.⁹⁷ iTunes enables people to purchase music from the comfort of their home or any location with an internet connection. Music can be purchased from iTunes for \$9.99 an album, or at a per song rate ranging from \$0.69 to \$1.29.⁹⁸ Record companies save a substantial sum of money by eliminating the cost of physical production and distribution of CD's, however the savings have not solved the recording industry's crisis of falling revenue.

Thirteen years before iTunes became the largest music retailer, recording companies sensed the coming of a digital age. Since 1995, as the proud owners of sound recording copyrights, record labels have earned revenue when their sound recordings are broadcast on the internet. This right does not exist when songs are broadcast on terrestrial radio. The laws that shape internet radio were influenced greatly by relationships between recording companies and terrestrial radio stations. These laws were shaped differently than those copyright laws arising from the printing press and player piano inventions. Here, laws were drafted before technology and business models matured or influenced distribution and consumption of intellectual property.

⁹⁴ Kristen Lee Repynek, *Note: The Ghost of Alan Freed: An Analysis of the Merit and Purpose of Anti-Payola Laws in Today's Music Industry*, 51 Vill. L. Rev. 695, 701 (2006).

⁹⁵ Courtney Love, *Courtney Love Does the Math*, June 14, 2000, <http://www.salon.com/tech/feature/2000/06/14/love> (last visited April 22, 2010).

⁹⁶ Knopper, *supra* note 92, at 33.

⁹⁷ IFPI, Digital Music Report 2009 New Business Models For a Changing Environment, at 10 <http://www.ifpi.org/content/library/DMR2009.pdf> (last visited April 22, 2010).

⁹⁸ Antony Bruno and Glenn Peoples, *The Price you Pay*, Billboard Magazine, June 27, 2009.

II. The Important Role of Radio

A. Historical Rise of Radio and Federal Regulation

Radio broadcast technology was invented by Italian physicist Guglielmo Marconi in 1895.⁹⁹ The technology allows sound and images to be transmitted wirelessly by electrical energy over the radio wave spectrum.¹⁰⁰ An early problem with radio was static and overlapping broadcast interference caused by multiple broadcasts over the same waves.¹⁰¹ In 1912 Congress passed the first Radio Act with the goal of regulating broadcasts and curbing static interference.¹⁰² The Radio Act of 1912 required radio operators to apply for a license issued by the Secretary of Commerce and Labor in order to legally broadcast.¹⁰³ Four companies owning patents for most of the electrical equipment necessary to produce radio equipment joined forces to establish the Radio Corporation of America (RCA).¹⁰⁴ RCA and its subsidiary companies controlled most of the early radio programming, and made its profits only from the sale of radio units. In 1922 not one of the 400 licensed radio stations in America sold advertising time during their broadcasts.¹⁰⁵

Washington Senator Clarence Dill introduced the Radio Act of 1927, as a replacement to the 1912 Act.¹⁰⁶ Under the 1927 Act, the newly formed Federal Radio Commission (FRC) was empowered to regulate radio waves and issue limited term licenses for station operation.¹⁰⁷ By this time, advertisers established a presence on the radio. A lasting contribution and regulation

⁹⁹ Wilfrid C. Rumble, *Comment: The FCC's Reliance on Market Incentives to Provide Diverse Viewpoints on issues of Public Importance Violates the First Amendment Right to Receive Critical Information*, 28 U.S.F. L. Rev. 793, 809 (1994).

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² Radio Communications Act of 1912, Pub. L. No. 62-264, 37 Stat. 302 (1912).

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ Rumble, *supra* note 99, at 810.

¹⁰⁶ *Id.* at 812.

¹⁰⁷ Radio Act of 1927, Pub. L. No. 69-632, ch. 169, 3, 44 Stat. 1162, 1162-63 (1927).

present in the Radio Act of 1927 was a requirement that any sponsored broadcast required an accompanying announcement disclaiming who paid for the broadcast material to be aired.¹⁰⁸ Regulations issued by the FRC reflected a tradition of thought known as the “Public Interest Doctrine.”¹⁰⁹ First articulated by Herbert Hoover during his tenure as the Secretary of Commerce under Presidents Warren G. Harding and Calvin Coolidge in the 1920’s, the doctrine views radio operators as public trustees with a duty to put the public interest ahead of their own business interests.¹¹⁰ The FRC was replaced by the Federal Communications Commission (FCC) in the Communications Act of 1934.¹¹¹

When the Communications Act of 1934 was passed, ninety-eight percent of broadcasting stations were commercialized.¹¹² As profits increased from radio advertisements, ownership of stations became consolidated.¹¹³ The FCC established Chain Broadcasting Rules setting limits to the ownership of stations and exclusivity of broadcasting content.¹¹⁴ In 1953, no single entity could own more than 14 radio stations.¹¹⁵ The goal of the regulations was to further the public interest doctrine and assure that consumers received a wide range of programming content and views. Since its inception, the FCC has made clear that disclosure of advertising and limitations on station ownership are principles necessary to maintain the public interest in broadcast radio and free speech.

¹⁰⁸ *Id.*

¹⁰⁹ Radio Act of 1927, Pub. L. No. 69-632, ch. 169, 9, 44 Stat. 1162, 1166 (1927).

¹¹⁰ Alon Rotem, *Comment: Legitimizing Pay to Play: Marketizing Radio Content Through a Responsive Auction Mechanism*, 14 UCLA Ent. L. Rev. 129, 131 (2007). *See also*, *NBC v. United States*, 319 U.S. 190, 226 (1943) (upholding as valid, the expansive right to issue regulatory rules and licenses for the operation of radio stations. In 1943 the court opined “the right of free speech does not include, however, the right to use the facilities of radio without a license... The standard... provided for the licensing of stations was the “public interest, convenience, or necessity.” Denial of a station license on that ground, if valid under the Act, is not a denial of free speech.”)

¹¹¹ The Communications Act of 1934, Pub. L. No. 73-416, 48 Stat. 1064 (1934).

¹¹² 78 Cong. Rec. 8829 (1934).

¹¹³ Rumble, *supra* note 99, at 816.

¹¹⁴ FCC, Report on Chain Broadcasting, Docket No. 5060 (1941).

¹¹⁵ Peter DiCola *False Premises: A quantitative History of Ownership Consolidation in the Radio Industry* at 21 (December 2006) available at www.futureofmusic.org/research (Stating that over time the limitations on station ownership were relaxed. By 1994, single entities could own a total of 40 stations) (last visited April 22, 2010).

B. Payola and the Recording Industry's Relationship with Radio.

“Payola” is a term of art first introduced in a 1938 article in the trade magazine *Variety*.¹¹⁶ The term refers to the practice of recording companies making undisclosed payments of cash or kind in return for the broadcast of certain music in radio broadcasts.¹¹⁷ The practice of paying others to perform one's music dates back to the 1800's when the owners of copyrights in sheet music would pay band leaders to perform and popularize their songs in an effort to increase sales of sheet music and royalty payments.¹¹⁸ Radio became the ultimate advertising instrument for corporations because the public can hear what is played in their homes, cars, and anywhere else a radio is present. Radio airplay is viewed by the recording industry as advertising for new albums,¹¹⁹ providing consumers of radio the benefit of previewing a product before purchasing it. Because record companies typically own copyrights in the sound recordings of their artists, but not the song compositions, record company revenue is driven by royalties earned on album sales while no income is directly generated from radio play.¹²⁰

In the 1950's, payola grew rampant between recording labels and radio disk jockeys due in large part to supply and demand economic conditions.¹²¹ In exchange for playing records, individual disc jockeys were given cash payments, royalties, and other lavish gifts that in some cases doubled their salaries.¹²² Because there are more songs produced than there exists time to play them on the radio, payola worked as a pricing mechanism dividing the scarce resource of

¹¹⁶ Kristen Lee Repynek, *Note: The Ghost of Alan Freed: An Analysis of the Merit and Purpose of Anti-Payola Laws in Today's Music Industry*, 51 Vill. L. Rev. 695, 696 (2006).

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 698.

¹¹⁹ *Id.* at 701.

¹²⁰ 17 U.S.C. § 106 (1976).

¹²¹ Repynek, *supra* note 116, at 699.

¹²² Devin Kosar, *Note: Payola- Can Pay-For-Play be Practically Enforced?* 23 St. John's J.L. Comm. 211, 218 (2008).

radio airtime to those songs that record companies would pay the most to get played.¹²³ Of all the disc jockey's who took bribes, Alan Freed became the most famous after he was indicted on May 19, 1960 and charged with taking bribes to play records.¹²⁴ Freed pled guilty to accepting a total of \$2,500 in bribes, but omitted stating that he was given writing credit for Chuck Berry's first hit "Maybellene" by executives at the Chess Brothers recording company in exchange for playing the song and promoting it to hit single status.¹²⁵

Following the Alan Freed scandal, Congress amended the FCC regulations in 1960 to more directly penalize and discourage pay-for-play arrangements. The most notable changes were to § 317 and § 508 of the statute.¹²⁶ The changes require that radio stations disclose to the public at the time of broadcast, any receipt of significant consideration in exchange for broadcasting certain content.¹²⁷ Station employees are also required to notify the licensee when consideration is exchanged for broadcasting content.¹²⁸ The articulated reasons for the policy change is to inform the public that it is hearing music that was paid for, so the radio audience knows who is attempting to persuade it.¹²⁹ Record labels and radio station employees found to be in violation of the disclosure requirement can be subject to criminal penalties of up to a year in jail and fines of up to \$10,000.¹³⁰ At no time has Congress made it illegal for record companies to compensate radio stations for playing music, it is simply mandated that any fund

¹²³ Repynek, *supra* note 116, at 699.

¹²⁴ Dannen, *supra* note 93, at 43.

¹²⁵ *Id.*

¹²⁶ 47 U.S.C. 317, 508 (1960).and 47 U.S.C. 508 (1960).

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ Repynek, *supra* note 116, 695.

¹³⁰ Lauren J. Katunich *Time to Quite Paying the Payola Piper: Why Music Industry Abuse Demands a Complete System Overhaul*, 22 Loy. L.A. Ent. L. Rev. 643, 647 (2001).

transfers are disclosed so as not to mislead the public into believing the music is being played solely for its artistic or commercial merit.¹³¹

In the aftermath of the Alan Freed payola scandal pay-for-play did not stop, but it became more sophisticated and indirect. Record companies began circumventing the payola statutes by subcontracting with independent promoters who acted as brokers for hit singles backed by record label support.¹³² A Group of fewer than 30 independent promoters known collectively as “The Network” had direct connections to the 41 most important radio stations in the 24 most influential radio stations in America.¹³³ The Network funneled large sums of money to radio stations in exchange for radio play, often keeping thousands of dollars as a brokering fee.¹³⁴

During the 1980’s independent promotion became the surefire way to guarantee a hit single. Even top artists such as Michael Jackson used independent promotion to get songs played on the radio.¹³⁵ Jackson’s manager Frank Dileo admitted paying approximately \$100,000 to individually promote each hit single released from the “Thriller” album.¹³⁶ In 1985 Warner Music Group spent \$6 million while CBS Records spent almost \$13 million on independent promotion.¹³⁷ For CBS, the amount spent on promotion was nearly 10% of all pretax profits.¹³⁸ Finally in 1986, NBC Nightly News exposed the role of independent promoters in getting music played on the radio in a feature news story.¹³⁹ The scandal resulted in a second round of payola related litigation. One Los Angeles promoter Joe Isgro pled guilty to tax evasion after having been charged with 57 felony counts including bribery, racketeering, and conspiracy to distribute

¹³¹ *Id.*, at 643.

¹³² Repynek, *supra* note 116, at 707.

¹³³ Kosar, *supra* note 122, at 223.

¹³⁴ Dannen, *supra* note 93.

¹³⁵ *Id.* at 228.

¹³⁶ *Id.*

¹³⁷ *Id.* at 264

¹³⁸ *Id.*

¹³⁹ Kosar, *supra* note 122, at 226.

cocaine.¹⁴⁰ All of these charges were directly related to Isgro's work as an independent music promoter.¹⁴¹ The Network was damaged and payola was again curbed but would not go away for good.

The most revolutionary change in radio legislation since the Radio Act of 1927 was enacted with the 1996 Telecommunications Act, which resulted in significant deregulation of the broadcast radio industry.¹⁴² The goal of the 1996 Act was to "promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."¹⁴³ Prior to 1996, the FCC granted revocable 8 year licenses for the operation of radio frequencies.¹⁴⁴ Station owners were required to petition for license renewals at the end of the license term.¹⁴⁵ Following the 1996 Act, the FCC must renew a license so long as the licensee has committed no serious violations of the Communications Act, FCC rules, or otherwise exhibited a pattern of abuse on the airwaves.¹⁴⁶

The Telecommunications Act of 1996 also repealed the national radio ownership limit which as of 1994, capped the number of stations a single company could own at 40.¹⁴⁷ A rush of ownership consolidation occurred during in the decade following deregulation. Soon after the 1996 Act, 4,000 of America's 11,000 radio stations changed ownership.¹⁴⁸ In 1995 more than 6,600 companies owned radio stations in the United States. By 2005 that number shrank

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² Rotem, *supra* note 110, at 134.

¹⁴³ See Anastasia Bednarski, *From Diversity to Duplication Mega-Mergers and the Failure of the Marketplace Model Under the Telecommunications Act of 1996*, 55 Fed. Comm. L.J. 273, 275 (2003) (citing Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56).

¹⁴⁴ Rotem, *supra* note 110, at 134.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ DiCola, *supra* note 115.

¹⁴⁸ Repynek, *supra* note 116, at 727.

by 1/3 to slightly more than 4,400 radio station owners.¹⁴⁹ Concentration of advertising revenue became more consolidated as well. In 1993 the four largest radio station owners collected 12% of the national advertising revenue, but this figure increased to 50% of advertising revenue being consolidated in the top four companies by 2004.¹⁵⁰ Consolidation of radio ownership aided in the returned growth of payola. Record executives were now in a position to negotiate large promotion deals with a string of stations by talking to only one corporate entity.¹⁵¹

Record companies helped to create a monster through independent promotion. The FCC's limited regulatory powers only allowed the entity to exercise its discretion to investigate allegations of payola violations if a formal complaint was filed.¹⁵² If the FCC found that a payment for broadcast occurred without the requisite immunizing disclosure, it then was required to turn the investigation over to the Department of Justice for enforcement of the policy.¹⁵³ Procedural hurdles kept enforcement of FCC rules from occurring efficiently and being taken seriously. In 2000, the nation's largest radio station owner Clear Channel Communications was fined \$8,000 for multiple payola violations.¹⁵⁴ This fine was hardly a deterrent considering the company had gross revenue of almost \$8 billion.¹⁵⁵ Estimates suggest that \$12 billion was spent on payola incentives by recording companies in 2001.¹⁵⁶

Lack of federal enforcement pushed New York Attorney General Elliot Spitzer to launch an investigation into suspected payola practices at the big four record companies Universal Music Group, Warner Music Group, EMI, and Sony-BMG in 2003.¹⁵⁷ The investigation resulted

¹⁴⁹ DiCola, *supra* note 115.

¹⁵⁰ *Id.*

¹⁵¹ Kosar, *supra* note 122, at 230.

¹⁵² Katunich, *supra* note 130, at 649.

¹⁵³ *Id.*

¹⁵⁴ *Id.* at 652.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 643.

¹⁵⁷ Kosar, *supra* note 122, at 235.

in the most significant fines imposed for violations of payola related laws to date. More than \$36 million in fines were levied against the four companies, and each acknowledged having improperly paid for music to be played on the radio without on air disclosure.¹⁵⁸ The effect of Spitzer's crusade produced the unexpected result of shrinking and standardizing station playlists. Tom Calococi, program director at KKBT in Los Angeles explained "no programmer wants to draw attention by choosing songs too far outside the mainstream. Many programmers say that fear of regulatory scrutiny has scared them into airing fewer songs. Instead, many stations are sticking to older, more tried-and-true tunes that seem less likely to prompt speculation that money changed hands."¹⁵⁹

Together, broadcasters and recording companies have a complicated history that had developed into a symbiotic relationship where each depends upon the other to generate income. Legislative lobbying organizations representing the radio and recording industries have worked closely since the mid 1990's to advance legislation with mutual benefits.¹⁶⁰ The National Association of Broadcasters (NAB) and the Recording Industry Association of America (RIAA) have used their common historical bond to build a sustainable future through legislation rather than innovation.¹⁶¹ Efforts by these organizations have threatened the growth of music based internet industries.

¹⁵⁸ *Id.* at 236.

¹⁵⁹ Rotem, *supra* note 110, at 139 (citing Charles Duhigg, Radio Stations Play It Safe Amid Legal Probe, L.A. Times, Apr. 8, 2006, at A1).

¹⁶⁰ Spector, *supra* note 54, at 19-20.

¹⁶¹ *Id.*

III. Introduction to Internet Radio and Digital Copyright Law

*“Intellectual property law cannot be patched, retrofitted, or expanded to contain digitized expression any more than real estate law might be revised to cover the allocation of broadcasting spectrum. We will need to develop an entirely new set of methods as befits this entirely new set of circumstances.”*¹⁶² - John Perry Barlow (Lyracist for the Grateful Dead and co-founder of Electronic Frontier Foundation. Stated in 1994).

A. Introduction to Internet Radio and the Technology that Drives it.

Over time, technology has shrunk the physical size of audio files. In the graveyard of yesterday’s audio technology, one can find piano rolls, reel to reel magnetic tapes, vinyl records, 8-track tapes, audio cassettes, mini disks, compact disks and more. History will show that two key steps to bringing about internet audio technologies were the shrinking of audio files to the MP3 format, and increasing bandwidth. According to the FCC, broadband high speed internet refers to data transmission in excess of 200,000 bits per second, or approximately 0.024 megabytes per second.¹⁶³ Increasing the speed at which data travels over the internet, enables users to receive streaming audio in real time as it is broadcast from a webcaster.¹⁶⁴

The movement to create today’s easily transferable small digital files began materializing in 1988 when Leonardo Chiariglione approached the International Organization for Standardization with the goal of establishing a universal standard format for digital transmission of audio-visual content.¹⁶⁵ At the time Chiarglione worked for Telecom Italia’s Centro Studie

¹⁶² John Perry Barlow, *The Economy of Ideas*, Wired Magazine (March 1994).

¹⁶³ <http://www.fcc.gov/cgb/broadband.html>, and <http://www.ibeast.com/content/tools/band-calc.asp> (calculating file rate conversions) (last visited April 22, 2010).

¹⁶⁴ Kidd, *supra* note 65, at 343 (citing *Congressional Testimony before the House Energy and Commerce Committee*, 107th Cong. (Apr. 25, 2002) (Statement of Larry Jacobson, Pres. And CEO, Real Networks explaining that “streaming enables consumers to enjoy uninterrupted, real-time broadcasts over the Internet, by compressing digital media files and dividing them into packets, that then are delivered to the consumer’s personal computer”)).

¹⁶⁵ Mann, *supra* note 6

Labratori Telecomunicazioni, which has been described as the “Bell Labs” of Italy.¹⁶⁶ In the Spring of 1988, Chiarglione formed the Moving Picture Experts Group (MPEG) in order to invent the new audio-visual technology. Without the assistance of music industry insiders, MPEG built a program known as a “codec” that was capable of shrinking large audio files to 1/12 of their original size.¹⁶⁷ The codec built MP3 files by removing audio frequencies that are captured by audio recordings but not registered by the human ear when listening to music playback.¹⁶⁸ In the end, a significantly smaller file can be produced without most listeners noticing a difference between the original file and the shrunken MP3 file.¹⁶⁹

The MP3 codec was improved by researchers at the University of Erlangen, Germany.¹⁷⁰ Officially, the MP3 was created there in 1992.¹⁷¹ An anonymous hacker known as SoloH stole the codec program from an unsecured computer at the University of Erlangen.¹⁷² SoloH improved the program so it could be used to quickly copy or “rip” compact-disk files into the MP3 format. With the new program in hand, SoloH distributed the codec for free on the internet and the program spread quickly to end users.¹⁷³ In the hands of end users, the MP3 codec helped create a culture of accepted piracy where transmission of free audio files was fast and inexpensive or free.¹⁷⁴ Compared to the copying of previously popular audio technologies such as cassette tapes, the digital MP3 format was an enormous technological advance because there is no noticeable degradation of quality each time a reproduction is made.¹⁷⁵

¹⁶⁶ *Id.*

¹⁶⁷ Cook, *supra* note 89.

¹⁶⁸ Mann, *supra* note 6.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ Cook, *supra* note 89.

¹⁷⁵ *Arista Records, LLC v. Launch Media, Inc.*, 578 F.3d 148, 153 (2009).

One year after the MP3 was introduced to society, internet entrepreneur Carl Malamud launched the first computer-radio talk show, where he interviewed a different computer expert every week.¹⁷⁶ Malamud's early foray to internet broadcasting did not stream live as a "webcast," but instead offered a series of MP3 audio files to be downloaded and played on computers.¹⁷⁷ A year and a half later in January 1995, Malamud helped to launch the first 24 hour a day streaming internet radio service.¹⁷⁸ Produced by nonprofit organization The Internet Multicasting Company of Washington, Malamud's service primarily focused on government and politics.¹⁷⁹ Initial content included speeches and debates from both houses of Congress, speeches delivered at the National Press Club, and live performances from the Kennedy Center for the Performing Arts.¹⁸⁰

An early hurdle for internet radio was bandwidth limitations that prevented internet users with phone line internet connections from being able to stream music without choppy interruptions. Established in 1992, M-bone provided early technology allowing companies and individuals to convey audio and image data in real time over internet lines.¹⁸¹ M-Bone was used to air the first major internet multicast concert in November 1994, a Dallas, Texas concert performed by the Rolling Stones that was viewed by individuals all around the world.¹⁸² Technology utilized by M-bone provided an added advantage over the technologies used by

¹⁷⁶ Mary Lu Carnevale and John J. Keller, *Cable Company is Set to Plug Into Internet*, August 24, 1993 The Wall Street Journal.

¹⁷⁷ *Id.*

¹⁷⁸ Peter H. Lewis, *Internet Radio Station Plans to Broadcast Around the Clock*, September 19, 1994 The New York Times.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ Peter H. Lewis, *Business Technology; Peering Out a "Real Time" Window*, February 8, 1995. The New York Times.

¹⁸² *Id.*

Malamud. M-bone allows live broadcasts rather than downloads of programs produced in advance and made available to end users on websites.¹⁸³

Internet radio currently exists in several formats that are most easily distinguished as interactive and non-interactive. Within these two types of stations are subcategories and varying business models that provide either free or for fee services. Interactive webcasters provide listeners the opportunity to exert more control over the music they are listening to. Specifically, the Digital Millennium Copyright Act defines an interactive service as “one that enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording, whether or not as part of a program, which is selected by or on behalf of the recipient.”¹⁸⁴ Examples of interactive stations include Lala.com, Grooveshark.com, and the European Spotify.UK.¹⁸⁵ Users of these stations can select specific songs and artists to listen to. One can listen to an entire album, build a specific playlist of songs by one or multiple artists, and may be able to utilize a personalized streaming radio function. These are the sites greatly feared by the recording industry because it is believed that they pose a threat to album sales by providing music consumers the opportunity to hear entire albums on demand at no cost.¹⁸⁶ Currently, the aforementioned interactive stations offer free services for listeners, with revenues derived from advertising income. In Europe, Spotify plays short audio commercials between songs and offers users a subscription option that is

¹⁸³ *Id.*

¹⁸⁴ 17 U.S.C. §114(j)(7) (1976). *See* Arista Records, LLC v. Launch Media, Inc. 578 F.3d 148 (2009).

¹⁸⁵ Lala.com. *And* Grooveshark.com. *And* Spotify.com.

¹⁸⁶ Ian Youngs, *Warner Quits Free Music Streaming*, BBC News, Feb 10, 2010 (Warner Music Group CEO Edgar Bronsman Jr. quoted as saying “free streaming services are clearly not positive for the industry and as far as Warner Music is concerned will not be licensed.”).

advertisement free.¹⁸⁷ Included in the class of interactive stations are subscription services like Rhapsody, which offers streaming and temporary downloads for its users.¹⁸⁸

There are two main types of non-interactive services. First are those that operate like traditional terrestrial radio stations (including terrestrial stations that simulcast their analog broadcast digitally on the internet). These stations broadcast a steady stream of music to all listeners tuning in.¹⁸⁹ An example is Somafm.com, a traditional non-interactive broadcaster that provides 18 unique listening stations divided by genre of music.¹⁹⁰ Listeners select a station to stream but then have no control over what music will be heard.

The second group of non-interactive services is more difficult to define because the webcasters allow listeners to have some influence over the music they hear. Non-interactive stations are those that do not fit the description of an interactive station, and the determination is made on a case by case determination.¹⁹¹ In the course of formulating statutory law, the House of Representatives provided some guidance on how to distinguish interactive and non-interactive stations, describing interactive programs as those in which the “transmission recipient has the ability to move forward and backward between songs in a program... it is not necessary that the transmission recipient be able to select the actual songs that comprise the program.”¹⁹² On April 17, 2000 the Digital Media Association (“DiMA”), a lobbying firm representing webcasters, asked the Copyright Office to adopt the following rule: “A Service making transmissions that otherwise meet the requirements for the section 114(f) statutory license is not rendered ‘interactive,’ and those ineligible for the statutory license, simply because the consumer may

¹⁸⁷ *Id.*

¹⁸⁸ Wagman, *supra* note 51, at 102.

¹⁸⁹ Kellen Myers *The RIAA, The DMCA, and Forgotten Few Webcasters: A Call for Change in Digital Copyright Royalties* 61 Fed. Comm. L.J. 431 (2008-2009).

¹⁹⁰ Somafm.com.

¹⁹¹ *Arista*, 578 F.3d, at 156.

¹⁹² H.R. Rep. No. 105-796, at 87-88 (Conf. Rep.).

express preferences to such Service as to the musical genres, artists and sound recordings that may be incorporated into the Service's music programming to the public.”¹⁹³ The Copyright Office declined to adopt DiMA's recommended language, explaining that because “of the rapidly changing business models emerging in today's digital marketplace, no rule can accurately draw the line demarcating the limits between an interactive service and a non-interactive service. Nor can one readily classify an entity which makes transmissions as exclusively interactive or non-interactive.”¹⁹⁴ Webcasters often don't know where they fit on the categorical landscape of internet radio. The uncertainty of the law can have the chilling effect of deterring entrepreneurs from innovating webcasting technologies.

In August, 2009, the Second Circuit Court of Appeals issued a significant decision for the webcasting community. The court held in Arista Records, LLC v. Launch Media, Inc., that webcasting services providing users with “individualized internet radio stations – the content of which can be affected by users' ratings of songs, artists, and albums,” are not an interactive service.¹⁹⁵ According to the Second Circuit, stations can operate democratically, allowing users to provide feedback that influences the frequency of play a song or artist receives. The two most successful services in this class are Pandora.com and Last.FM. Users of these stations pick one or more recording artists they like, and the station then streams a personalized radio station of artists resembling those requested by the listener. Users do not select the actual music they are hearing, allowing the stations to be classified as non-interactive. For both types of non-interactive stations, advertising income is the primary revenue source. By 2001, more than 80% of non-interactive webcasters sold advertising time and many solicit donations from listeners.¹⁹⁶

¹⁹³ *Arista*, 578 F.3d, at 156.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at 149.

¹⁹⁶ Kidd, *supra* note 65, at 344.

Both revenue streams enable these businesses to survive without charging subscription fees. The most successful of these companies, Pandora, earned an estimated \$40 million in revenue in 2009.¹⁹⁷

The laws in place to regulate and collect royalties from interactive and non-interactive internet radio stations were created before current technologies and business models were fully in place. 1995 is a particularly important year as it marks the birth of Malamud's 24 hour streaming service¹⁹⁸ and the passage of the first significant laws to effect internet radio.¹⁹⁹ Law was created to curb threats to copyright owners before the threats even existed. The result is a statutory scheme that has stifled technological and creative growth for internet entrepreneurs. Arguably, the laws in place damage the relationship between musicians and consumers of music by making it more difficult for music fans to listen to more music and be exposed to new music.

B. Digital Copyright Law

Recall the discussion in section 1 regarding the lack of an exclusive right to public performance in sound recording copyrights. During the seventy eight years from 1926 through 2004, more than 25 bills were introduced in Congress with the goal of gaining a full public performance right in sound recordings.²⁰⁰ Many of the proposed laws pitted lobbying giants, the National Broadcasters Association (NAB) representing terrestrial radio industries against the Recording Industry Association of America (RIAA) representing recording companies. Past disputes were resolved when the RIAA and NAB opted to preserve the status quo system of payola and radio serving as advertising for album sales. So long as album sales were projected

¹⁹⁷ Claire Cain Miller, *Music Labels Reach Online Royalty Deal*, New York Times July 8, 2009.

¹⁹⁸ Lewis, *supra* note 178.

¹⁹⁹ Moser, *supra* note 71, at 85.

²⁰⁰ DelNero, *supra* note 40.

to increase, the RIAA constituents were content backing off calls for a public performance right in sound recordings. The NAB vehemently opposed efforts of the RIAA to pass copyright reform legislation that would entitle sound recording owners to collect royalty payments each time sound recordings were broadcast publicly.²⁰¹ With the introduction of the first internet radio broadcasts and easily transferable MP3 files, the RIAA and NAB formed a coalition to push through legislation to preemptively curb the growth of internet music technologies.²⁰²

i. The Digital Performance Right in Sound Recordings Act of 1995 and the Digital Millennium Copyright ACT of 1998.

The history of music copyright law as illustrated by legislation relating to the printing press and player piano demonstrate that a logical order of events should precede legislation. First, a new technology is invented that influences the way in which intellectual property is reproduced and distributed. Next, new business models arise that use the new technology to exploit copyrighted intellectual property. This exploitation results in the need for expanded rights to assure that copyright owners are adequately compensated for use of their creations. Laws covering internet radio were not created in this manner. Instead, interests representing aging business models saw a potential threat in new digital technologies and preemptively sought legislation to curb that threat rather than evolve.²⁰³

In 1995 Congress passed the Digital Performance Right in Sound Recording Act (DPRSRA), granting owners of sound recording copyrights the limited exclusive right to public performance of digital audio formats.²⁰⁴ Adding a sixth exclusive right for recording owners

²⁰¹ Spector, *supra* note 54, at 19-20.

²⁰² *Id.*

²⁰³ Party, *supra* note 90, at xv.

²⁰⁴ Moser, *supra* note 71, at 85.

meant they could now collect publishing and performance royalties for digital broadcasts for the first time.²⁰⁵ Royalties are allocated 50-50 between performing artists and sound recording copyright owners.²⁰⁶ The DPRSRA also expanded the compulsory mechanical license provision to digital reproductions of music files.²⁰⁷ It is the self proclaimed goal of the DPRSRA to

“... provide copyright holders of sound recordings with the ability to control the distribution of their product by digital transmissions, without hampering the arrival of new technologies, and without imposing new and unreasonable burdens on radio and television broadcasters, which often promote, and appear to pose no threat to the distribution of sound recordings.”²⁰⁸

True to its goal, the DPRSRA included an exemption for terrestrial radio stations also broadcasting over the internet.²⁰⁹

The DPRSRA did not directly reference internet radio, but as intended by the RIAA and NAB, it has been the major influence in webcasting law.²¹⁰ The law was enacted on the recording industry’s own false assumption that internet radio would be primarily paid for by subscription business models.²¹¹ In reality, internet radio evolved to be predominantly funded by advertising revenue.²¹² By seeking to protect older technologies, the DPRSRA required only webcasters who charged listeners to receive their broadcasts to make royalty payments while exempting broadcasters who more closely resembled free terrestrial radio broadcasts.²¹³ It was believed that webcasters charging for services were far more likely to broadcast through

²⁰⁵ Wagman, *supra* note 51, at 98.

²⁰⁶ Copyright Royalty Board Rate Setting Proceedings <http://www.loc.gov/crb/proceedings/2005-1/rates-terms2005-1.pdf>, at page 11 (last visited April 22, 2010).

²⁰⁷ Moser, *supra* note 71, at 85.

²⁰⁸ 65 Fed. Reg. 77,292 (Dec. 11, 2000) (citing S. REP. NO. 104-128, at 15 (1995)).

²⁰⁹ Spector, *supra* note 54, at 24.

²¹⁰ Kidd, *supra* note 65, at 348.

²¹¹ Kohn & Kohn, *supra* note 22, at 1299.

²¹² *Id.* at 1300.

²¹³ See Digital Performance Right in Sound Recordings Act, Pub. L. No. 104-39, 109 Stat. 366 (Nov. 1, 1995). See also 17 U.S.C. § 114(f) (1995).

interactive means that allowed consumers to determine what music was played on demand.²¹⁴ Interactive services were thought to pose a greater danger to displacing record sales. For services required to pay royalties, the DPRSRA did not set royalty rates. The Act required webcasters and sound recording owners to negotiate rates independently with sound recording copyright owners.²¹⁵ According to the vision of legislators, a webcaster had to negotiate with many record labels, artists and publishers in order to acquire licenses to broadcast a wide selection of music.

In June 1998, the RIAA wrote a letter to 40 of the most prominent non-subscription internet radio stations stating that a license was now required in order to stream audio recordings over the internet.²¹⁶ This letter contributed to a growing rift between webcasters and the recording industry, as the RIAA sought to unilaterally expand the law's interpretation of those rights provided in the DPRSRA. The letter written by Steven Marks, vice president and deputy general counsel for the RIAA, stated "you may not realize it, but webcasting implicates the rights of the record companies that create those recordings. Specifically, the reproduction of sound recordings in your computer hardware and digital transmission of those sound recordings require a license from the respective sound recording owners."²¹⁷ The RIAA demand would have required all streaming radio stations to pay royalties even if they were non-interactive, did not charge subscription fees, or were terrestrial radio stations simulcasting broadcasts over the internet.²¹⁸ Although the RIAA demand was contrary to and exceeded the scope of the

²¹⁴ Kidd, *supra* note 65, at 348.

²¹⁵ *Id.*

²¹⁶ Kohn & Kohn, *supra* note 22, at 1300.

²¹⁷ Beth Lipton Krigel, *Music Firms Mull Net Copyright Claim*, CNET June 15, 1998, available at http://news.cnet.com/Music-firms-mull-Net-copyright-claim/2100-1023_3-212279.html (last visited April 22, 2010).

²¹⁸ *Id.*

DPRSRA, the RIAA's tactic resulted in expanding the number of internet broadcasters required to pay royalties and obtain licenses.²¹⁹

After receiving the RIAA letter, webcasters joined together to form the Digital Media Association (DiMA), which served as the lobbying organization that would battle the RIAA over new digital copyright laws to be considered by Congress.²²⁰ DiMA and the RIAA were brought together by the Register of Copyrights at the Copyright Office in Washington D.C. and told to draft proposed legislation that was mutually acceptable. The proposed legislation was included by the House of Representatives in the DMCA and passed into law on August 4, 1998.²²¹ Together, the DPRSRA and DMCA amended § 114 of the Copyright Code to create three classes of digital broadcast mediums, those that are exempt from obtaining performance licenses, those subject to compulsory licenses, and those subject to negotiated licenses.²²²

Digital broadcasts that are exempt from paying performance royalties are those transmitted over traditional non-internet driven airways.²²³ An example is Hybrid Digital (commonly known as "HD Radio") radio broadcasts, in which a specially equipped radio receiver plays data transmitted in both digital and analog signals.²²⁴ The broadcasts are played in a higher audio quality than pure analog radio, require no subscription fee, and allow for more stations to be broadcast than on analog only frequency radios. Despite being digital, these transmissions fall under the DPRSRA-DMCA exemption and do not trigger the exclusive public performance right in digital sound recordings. Broadcasts subject to the compulsory license

²¹⁹ Kohn & Kohn, *supra* note 22, at 1300.

²²⁰ *Id.* at 1301.

²²¹ *Id.*

²²² 17 U.S.C. § 114 (1998).

²²³ 17 U.S.C. §114 (d)(1) (1998).

²²⁴ How Hybrid-Digital Radio Works, *available at* http://www.hdradio.com/how_does_hd_digital_radio_work.php

include those that are free or charge a subscription but are not interactive.²²⁵ End users have minimal or no control over what music is played and must comply with a lengthy list of requirements mostly intended to prevent copyright infringement.²²⁶ These services include satellite radio broadcasters Sirius-XM, as well as terrestrial radio station digital simulcasts, and internet only webcasters such as Soma.FM and Pandora.com. Compulsory license eligible broadcasters must satisfy 13 requirements.²²⁷ The requirements prohibit stations from providing advanced notice of the songs they will broadcast, from maintaining lengthy archives of performances, and from repeating broadcasts within a certain period of time.²²⁸

Under the DMCA, webcasters eligible for the compulsory license could pay one industry-negotiated rate, or a government mandated rate set by the Copyright Office.²²⁹ Any qualifying broadcaster need only to file a notice of intent to obtain a compulsory license with the Copyright Office.²³⁰ Interactive streaming services on the other hand, must negotiate directly with sound recording copyright holders in order to obtain a digital broadcast license. Because users have control over the music they are hearing, there is a perceived heightened risk that users will circumvent technology to copy the audio transmission.²³¹ Copyright owners are entitled to negotiate licenses or refuse them to all interactive broadcasters.²³²

In the event that copyright owners and webcasters could not independently negotiate a royalty rate they could petition the Librarian of Congress to convene a Copyright Arbitration

²²⁵ 17 U.S.C. §114 (d)(2) (1998).

²²⁶ Kohn & Kohn, *supra* note 22, at 1373.

²²⁷ Kidd, *supra* note 65, at 350.

²²⁸ 17 U.S.C. §114 (d)(2) (1998).

²²⁹ Kidd, *supra* note 65, at 350.

²³⁰ Moser, *supra* note 71, at 88.

²³¹ Kohn & Kohn, *supra* note 22, at 1371.

²³² Ian Youngs, *Warner Quits Free Music Streaming*, BBC News, Feb 10, 2010.

Royalty Panel (CARP) to determine a reasonable royalty rate.²³³ CARP replaced the Copyright Royalty Tribunal, established under the Copyright Act of 1976 to set statutory license rates for cable retransmissions, jukeboxes, and noncommercial broadcasts of protected works.²³⁴ In determining royalty rates, CARP was charged to adhere to four policy objectives:

“(A) To maximize the availability of creative works to the public; (B) To afford the copyright owner a fair return for his creative work and the copyright user a fair income under existing economic conditions; (C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication; (D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.”²³⁵

Under the CARP system a convening panel had up to 180 days to recommend royalty rates to the Librarian of Congress. The Librarian would then consult the Register of Copyrights who had an additional 60 days to accept or reject the CARP recommendation.²³⁶ Parties submitting to CARP after being unable to negotiate a rate were told that CARP’s decision was based on the “willing buyer-seller standard.”²³⁷ While admirable, this goal of CARP (later continued by its replacement organization the Copyright Royalty Board) could never adequately be fulfilled considering that each CARP decision was rendered to resolve deadlocked negotiations between unwilling buyers and sellers. Congress articulated the willing buyer-seller standard for CARP in the 1998 Copyright Code as follows:

In establishing rates and terms for transmissions by eligible non-subscription services and new subscription services, the Copyright Royalty Judges shall establish rates and terms that most clearly represent the rates and terms that would

²³³ Brian Flavin, *A Digital Cry for Help: Internet Radio’s Struggle to Survive a Second Royalty Rate Determination Under the Willing Buyer/Seller Standard*, 27 St. Louis U. Pub. L. Rev. 427, 434 (2008).

²³⁴ *Id.* at 437.

²³⁵ Copyright Act of 1976, Pub. L. No. 94-553, §§801(b)(1)(A)-(D), 90 Stat. 2541 (1976)

²³⁶ Flavin, *supra* note 233, at 437.

²³⁷ *Id.* at 438.

have been negotiated in the marketplace between a willing buyer and a willing seller. In determining such rates and terms, the Copyright Royalty Judges shall base its decision on economic, competitive and programming information presented by the parties, including—

- (i) whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings; and
- (ii) the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk.²³⁸

The rate setting goals of CARP suggest that Congress envisioned rates to reflect nuanced differences among internet broadcasters. The willing buyer-seller standard was shaped to reflect whether a service was likely to increase or decrease sound recording sales, and piracy.²³⁹ These goals were never truly reflected. Instead, the RIAA and DiMA attempted to negotiate a blanket royalty rate for the entire industry that could sustain internet radio as a viable business and provide sound recording copyright holders with meaningful income. Initially, the RIAA offered a flat fee of \$0.004 for each song performance per listener. It is estimated that this rate would equal 15% of webcaster's gross revenue.²⁴⁰ DiMa's counter offer was \$0.0015 per "listener hour."²⁴¹ At first glance, these offers may not appear significantly different but further calculation shows the offers are very far from one another. A station broadcasting to 10,000 listeners per hour would pay \$15 an hour under the DiMA plan and \$400 an hour under the RIAA plan.²⁴² Over the course of a year the DiMA plan would cost the webcaster approximately

²³⁸ 17 U.S.C. §114 (f)(2)(B)(1998).

²³⁹ 17 U.S.C. §114 (f)(2)(B)(1998).

²⁴⁰ Myers, *supra* note 189, at 444.

²⁴¹ *Id.*

²⁴² *Id.* (citing Jeremy Delibero, Note, *Copyright Arbitration Royalty Panels and the Webcasting Controversy: The Antithesis of Good Alternative Dispute Resolution*, 5 Pepp. Disp. Resol. L.J. 83, 94-95).

\$ 192,000 compared to \$5.5 million under the RIAA proposal.²⁴³ There was no zone of possible agreement between the representative negotiating parties, and they entered CARP proceedings to resolve the rate dispute.

A CARP convened from July, 2000 until February, 2002 to set the compulsory licensing rate for the period of October, 1998 through December, 2002.²⁴⁴ Prior to its decision, one of the largest internet companies and radio broadcasters, Yahoo Inc. successfully negotiated a royalty rate with the RIAA.²⁴⁵ CARP viewed the Yahoo Inc. rate as the example of a reasonable market rate, and used the agreement to shape the compulsory rate for all other eligible webcasters.²⁴⁶ This first rate required internet only webcasters to pay \$0.0014 for each performance per listener, and \$0.0007 for each performance per listener for terrestrial stations simulcasting on the internet.²⁴⁷ Following an appeal from the webcasters, the Librarian of Congress rejected the CARP rate recommendations. Webcasters requested that the Librarian implement a revenue based royalty scheme.²⁴⁸ The Librarian rejected the request, based on a belief that a per-performance rate is more closely tied to the spirit of the public performance right held by copyright owners.²⁴⁹ The Librarian set the compulsory rate for all internet broadcasters at \$0.00074 for each performance, per listener.²⁵⁰ In rejecting the CARP rate, the Librarian sought parity among terrestrial and non-terrestrial broadcasters and continued the practice of using a one size fits all royalty rate to represent the willing buyer-seller standard.

²⁴³ *Id.*

²⁴⁴ U.S. Copyright Office, Summary of the Determination of the Librarian of Congress on Rates and Terms for Webcasting and Ephemeral Recordings (Jan. 8, 2003), http://www.copyright.gov/carp/webcasting_rates_final.html (last visited April 22, 2010).

²⁴⁵ Kidd, *supra* note 65, at 350, at 352.

²⁴⁶ U.S. Copyright Office, *supra* note 244.

²⁴⁷ *Id.*

²⁴⁸ Emily D. Harwood, *Note: Staying Afloat in the Internet Stream: How to Keep Web Radio from Drowning in Digital Copyright Royalties*, 56 Fed. Comm. L.J. 673, 686 (2004).

²⁴⁹ *Id.* at 689.

²⁵⁰ U.S. Copyright Office, *supra* note 244.

2000-2002 CARP Hearings

Party recommendation or determination	Rate	Estimated Hourly Fee 10,000 listener hours (15 songs/hour)	Estimated Annual Fee 10,000 listener hours (15 songs/hour)
RIAA	\$0.004 per song per listener	\$600	\$5,256,000
DiMA	\$0.0015 per listener hour	\$15	\$131,400
CARP	\$0.0014 per song per listener	\$210	\$1,839,600
Librarian of Congress	\$0.00074	\$111	\$972,360

ii. Subsequent Changes and Current Royalty Rates

Rates issued by the Librarian of Congress were viewed as burdensome by webcasters. In September of 2002, Representative James Sensenbrenner (R-WI) introduced the Small Webcaster Amendment Act (SWAA) which sought to give webcasters and the RIAA more time to negotiate royalty rates by delaying implementation of the new rates by six-months.²⁵¹ Before the SWAA was debated in the Senate, Senator Jesse Helms (R-NC) introduced an amendment to the SWAA that later became law as the Small Webcasters Settlement Act (SWSA).²⁵² The SWSA authorized SoundExchange, the then RIAA controlled entity responsible for collecting internet royalties, the authority to directly negotiate royalty rates with small webcasters.²⁵³ A subsequent agreement was negotiated between SoundExchange, and The Voice of Webcasters, a collective formed to represent several small webcasters.²⁵⁴ The agreement required webcasters to pay the greater of 8% gross revenues or 5% of expenses, covering the time from the passage

²⁵¹ Myers, *supra* note 189, at 449.

²⁵² Kidd, *supra* note 65, at 350, 357.

²⁵³ *Id.* at 358. See also, <http://soundexchange.com/category/faq/> (explaining that since 2003, SoundExchange has operated independent of the RIAA) (last visited April 22, 2010).

²⁵⁴ *Id.* at 361. And Voice of Webcasters <http://www.voiceofwebcasters.org/> (last visited April 22, 2010).

of the DMCA through the end of 2002.²⁵⁵ During the years 2003 and 2004, webcasters paid the greater of 10% of the first \$250,000 in revenue and 12% of gross revenues above that amount, or 7% of expenses.²⁵⁶ All webcasters were required to pay a minimum \$500 per year for 1998, and a minimum of \$2,000 per year for 1999 through 2002.²⁵⁷ For 2003 and 2004, those webcasters with gross revenues exceeding \$50,000 per year had to pay an increased minimum of \$5,000 per year.²⁵⁸ Arguably, these rates more closely reflect the spirit of the willing buyer-seller standard than those established by CARP or the Librarian of Congress, because royalties are tied to and capped in relation to revenue.

Despite the positive aspects of the new SoundExchange rates, significant problems remained.²⁵⁹ Webcasters seeking to directly negotiate with SoundExchange instead of accepting The Voice of Webcaster's rate had extremely limited bargaining power in negotiations.²⁶⁰ The decision for webcasters was to accept the royalty rate offered by SoundExchange, or opt instead for the higher rate offered by the Librarian of Congress.²⁶¹ Many webcasters stopped broadcasting due to burdensome royalty fees. Even Clear Channel, the largest owner of terrestrial radio stations, stopped streaming simulcasts for approximately 150 of its stations, citing high webcasting royalty fees as the unconquerable hurdle.²⁶² A national "Day of Silence" was held on May 1, 2002, on which webcasters spent a day on strike from broadcasting music to

²⁵⁵ Kidd, *supra* note 65, at 361 (Citing Notification of Agreement Under the Small Webcaster Settlement Act of 2002, 67 Fed. Reg. 78,510 (Dec. 24, 2002)).

²⁵⁶ *Id.* 339

²⁵⁷ *Id.*

²⁵⁸ *Id.*

²⁵⁹ Myers, *supra* note 189, at 448.

²⁶⁰ *Id.*

²⁶¹ *Id.* at 449.

²⁶² Harwood, *supra* note 248, at 689.

show their frustrations to legislators and the RIAA.²⁶³ The Congressional goal of establishing royalty rates based on the willing buyer-seller standard had yet to be realized, and stability for the recording industry and webcasters had yet to arrive as more changes were on the horizon.

On March 27, 2003, Congressman Lamar Smith (R-TX) introduced the Copyright Royalty Reform and Distribution Act.²⁶⁴ The act replaced CARP with the Copyright Royalty Board (CRB) which consists of three copyright royalty judges serving terms that are staggered and range from two to six years on the board.²⁶⁵ In 2007, the CRB issued the first royalty rate determination since 2002, and used the same willing buyer-seller standard formerly used by CARP.²⁶⁶ Hearings for the determination began in 2005, and the CRB considered written statements of twenty-three interested parties.²⁶⁷ The CRB justified its attempt to establish a one-size fits all royalty rate that could reflect the “significant variations among both buyers and sellers in terms of sophistication, economic resources, business exigencies and myriad other factors”²⁶⁸ by finding that Congress intended the CRB to determine webcasting rates “absent

²⁶³ Benny Evangelista & Edward Epstein, *Static over Net Radio/ Webcasters say Ruling on Royalties Could Silence Online Music*, San Francisco Gate, May 19, 2002. Available at: http://articles.sfgate.com/2002-05-19/business/17545947_1_webcasters-copyright-arbitration-royalty-panel-royalty-fees.

²⁶⁴ Emily D. Harwood, *Note: Staying Afloat in the Internet Stream: How to Keep Web Radio from Drowning in Digital Copyright Royalties*, 56 Fed. Comm. L.J. 673, 692 (2004).

²⁶⁵ Copyright Royalty Board, <http://www.loc.gov/crb/background> (last visited Apr. 3, 2010) (Currently, James Scott Sledge, William J. Roberts, and Stanley C. Wisniewski are the Copyright Royalty Judges, with Sledge acting as Chief Judge) (last visited April 22, 2010).

²⁶⁶ Brian Flavin, *A Digital Cry for Help: Internet Radio's Struggle to Survive a Second Royalty Rate Determination Under the Willing Buyer/Seller Standard*, 27 St. Louis U. Pub. L. Rev. 427, 438 (2008).

²⁶⁷ CRB Determination, 72 Fed. Reg. at 24,084-86. (“the parties to this proceeding are: (i) Digital Media Association and certain of its member companies that participated in this proceeding, namely: America Online, Inc. (“AOL”), Yahoo!, Inc. (“Yahoo!”), Microsoft, Inc. (“Microsoft”), and Live365, Inc. (“Live365”) (collectively referred to as “DiMA”); (ii) “Radio Broadcasters” (this designation was adopted by the parties): namely, Bonneville International Corp., Clear Channel Communications, Inc., National Religious Broadcasters Music License Committee (“NRBMLC”), Susquehanna Radio Corp.; (iii) SBR Creative Media, Inc. (“SBR”) and the “Small Commercial Webcasters” (this designation was adopted by the parties): namely, AccuRadio, LLC, Digitally Imported, Inc., Radioio.com LLC, Discombobulated, LLC, 3WK, LLC, Radio Paradise, Inc.; (iv) National Public Radio, Inc. (“NPR”), Corporation for Public Broadcasting-Qualified Stations (“CPB”), National Religious Broadcasters Noncommercial Music License Committee (“NRBNMLC”), Collegiate Broadcasters, Inc. (“CBI”), Intercollegiate Broadcasting System, Inc., (“IBS”), and Harvard Radio Broadcasting, Inc. (“WHRB”); (v) Royalty Logic, Inc. (“RLI”); and (vi) SoundExchange, Inc. (“SoundExchange”).”).

²⁶⁸ CRB Determination, 72 Fed. Reg. at 24,085-86.

special circumstances.”²⁶⁹ Once again, reality showed that a one size fits all royalty scheme cannot adequately model a true willing buyer-seller standard.

CRB’s determination reflected prior findings by CARP and the Librarian of Congress. Commercial webcasters were required to pay a per-performance royalty, while noncommercial broadcasters such as National Public Radio could pay a flat annual fee per station.²⁷⁰ Under the CRB’s April 2007 determination, noncommercial webcasters paid an annual fee of \$500 per station up to a total of 159,140 aggregate tuning hours (total listener hours) per month.²⁷¹ Broadcasts exceeding the aggregate tuning hour limit paid the commercial webcaster rate for remaining broadcasts.²⁷² Commercial webcasters were required to pay \$500 per station, which is used to offset additional fees for broadcasts per listener. The per play listening rate was scheduled at \$0.0008 for 2006, \$0.0011 for 2007, \$0.0014 for 2008, \$0.0018 for 2009, and \$0.0019 for 2010.²⁷³ Consider the fees incurred by America Online music, which averaged 210,694 listeners per streamed song during November 2006.²⁷⁴ Under the 2007 CRB determination, America Online retroactively owed \$1.65 million in public performance sound recording royalties for the month of November 2006.²⁷⁵

These rates continued to threaten the existence of internet radio stations. In 2008, Congress passed the Webcaster Settlement Act, delaying implementation of the 2007 rates to

²⁶⁹ Brian Flavin, *A Digital Cry for Help: Internet Radio’s Struggle to Survive a Second Royalty Rate Determination Under the Willing Buyer/Seller Standard*, 27 St. Louis U. Pub. L. Rev. 427, 445 (2008) (Citing CRB Determination, 72 Fed. Reg. at 24,085-86).

²⁷⁰ *Id.* at 447.

²⁷¹ Copyright Royalty Board Proceeding <http://www.loc.gov/crb/proceedings/2005-1/rates-terms2005-1.pdf> at pages 61-62 (last visited April 22, 2010).

²⁷² *Id.*

²⁷³ *Id.* at 47.

²⁷⁴ Eliot Van Buskirk, *Royalty Hike Panics Webcasters*, Wired March 6, 2007.

²⁷⁵ *Id.*

allow webcasters to engage in direct royalty negotiations with SoundExchange.²⁷⁶ In July 2009, a new agreement was reached between webcasters and SoundExchange that covers broadcasting for the period from 2006 through 2015.²⁷⁷ The deal applies to companies making most of their money from non-interactive internet streaming broadcasts, and excludes many simulcasting broadcasters like CBS Radio.²⁷⁸ Small webcasters, defined as those earning less than \$1.25 million in annual revenues pay 12-14% of revenue in royalties with a minimum annual payment of \$25,000.²⁷⁹ Larger webcasters pay the greater of 25% of revenue or a fee per listener stream that will increase by 57% from \$0.0008 in 2006 to \$0.0014 in 2015.²⁸⁰ Calculating royalty fees by assuming 10,000 listeners and 15 songs per hour, rates will increase from \$120/hour to \$210/hour. Over the course of nine years, rates will increase from \$1,051,200 to \$1,839,600. By tying royalty fees to revenue, webcasters are better equipped to organize their business growth and anticipate royalty expenses. The negotiations resulted in a closer relationship between SoundExchange and webcasters, who now provide SoundExchange with more elaborate data regarding what songs are streamed and to whom they are streamed to.²⁸¹

The most recent rates, established through negotiation are a positive step representing the willpower of internet radio stations to continue their growth against a backdrop of high costs and operational fees. The DPRSRA and DMCA were enacted before internet radio technologies and business models had the opportunity to mature. As a result, subsequent legislation and royalty rate adjustments over the past fifteen years have been tweaking the original legislation to bring it more closely in line with market realities. Internet technologies have emerged as the next big

²⁷⁶ Erich Carey *We Interrupt This Broadcast: Will the Copyright Royalty Board's March 2007 Rate Determination Proceedings Pull the Plug on Internet Radio?*, 19 Fordham Intell. Prop. Media & Ent. L.J. 257, 308 (2008).

²⁷⁷ Claire Cain Miller, MUSIC LABELS REACH ONLINE ROYALTY DEAL, New York Times, July 8, 2009.

²⁷⁸ *Id.*

²⁷⁹ *Id.*

²⁸⁰ *Id.*

²⁸¹ Claire Cain Miller, MUSIC LABELS REACH ONLINE ROYALTY DEAL, New York Times, July 8, 2009.

broadcasting mechanism. Consumer desires drive internet technologies, not control or copyright.²⁸² It is the consumer who gives value to delivery mechanisms as well as copyrighted materials.²⁸³ The marketplace of consumers demands that internet radio continue to evolve and deliver new dynamic ways for individuals to interact with and consume their music.

IV. The Current Business Outlook for Webcasters

Passage of the DPRSRA in 1995 and the DMCA in 1998 ushered in an era of law that has handicapped the growth of internet radio businesses. These laws were drafted prematurely without proper understanding of the technology and business models they would be stifling. There exists an ongoing war of recording industry superpowers against technologies that threaten their outdated business models.²⁸⁴ Led by the RIAA and the 4 major recording labels, subsequent legislation and SoundExchange negotiations taking place during the 2000's occurred against a backdrop of piracy fears and dwindling record sale income for recording companies. From the advent of Napster in 1999 to 2008 the recording industry lost an estimated \$20 billion dollars in decreased sales revenue.²⁸⁵ Internet technologies have been viewed as suspect by executives at the major labels even when legal and royalty income producing.

In February 2010, Warner Music Group CEO Edgar Bronfman Jr.²⁸⁶ told BBC News that his company would only license music to subscription services.²⁸⁷ Bronfman Jr. said "free

²⁸² Patry, *supra* note 90, at xx.

²⁸³ *Id.*

²⁸⁴ *Id.* at xv.

²⁸⁵ IFPI, *Recorded Music Sales 2008*, <http://www.ifpi.org/content/library/Recorded-Music-Sales-2008.pdf> (showing that global sales of recorded music totaled \$18,415,200,000 in 2008). And IFPI, *2000 Recording Industry World Sales*, April 2001, <http://www.ifpi.org/content/library/worldsales2000.pdf> (showing that global sales of recorded music totaled \$38,900,000,000) (last visited April 22, 2010).

²⁸⁶ Kenneth N. Gilpin & Eric Schmitt, *Edgar Bronfman Jr. In Line at Seagram*, The New York Times, Feb 27, 1986 (Edgar Bronfman Jr. has a curious past that may shed light on his business policy decisions at Warner Music Group. Bronfman Jr. is a member of one of the wealthiest Canadian families, who owned the beverage enterprise Seagram Company. Bronfman Jr. never attended college but was anointed at age 30 to be the next CEO of Seagram Company. Comments made by Bronfman Jr. that aggressively challenge free access to music make a great deal of sense behind the context of his family history. The liquor industry is heavily regulated by government and generally considered recession proof. Moreover, nobody drinks for free.).

streaming services are clearly not net positive for the industry and as far as Warner Music is concerned will not be licensed. The get all your music you want for free... is not the kind of approach to business that we will be supporting in the future.”²⁸⁸ Bronfman’s opinion aside, data suggests that musicians and the public are fans of internet radio technology. The rights afforded to sound recording copyright owners under the DPRSRA will not be repealed, however the royalty structure must be revised to fulfill the goals of the DPRSRA so new technological growth is encouraged and copyright owners feel fairly compensated.²⁸⁹

The first decade of the new millennium welcomed the maturity of digital music. The decade began with Napster, which illegally delivered 2.71 billion copyrighted files per month²⁹⁰ and ended with unlimited free legal streaming of music through Pandora, Spotify, and Grooveshark among other services.²⁹¹ Contemporaneous to the 2003 filing of more than 38,000 lawsuits by the RIAA against music fans for alleged piracy,²⁹² musicians embraced digital music technologies. According to the Pew Center, by 2004, 83% of musicians independently provided free samples or previews of their music on the internet as a means of connecting with fans and promoting music.²⁹³ Trends show that consumers of music are also increasing their use of internet streaming music. At its height, Napster had 26.4 million users around the globe.²⁹⁴ By mid 2009, an estimated 69 million Americans listened to internet radio monthly.²⁹⁵ At least 20%

²⁸⁷ Ian Youngs, *Warner Quits Free Music Streaming*, BBC News, Feb 10, 2010.

²⁸⁸ *Id.*

²⁸⁹ 65 Fed. Reg. 77, 292 (Dec. 11, 2000) (citing S. Rep. NO. 104-128, at 15 (1995)).

²⁹⁰ Sarah Riedel, *A Brief History of File Sharing: From Napster to Legal Music Downloads*, February 24, 2006, http://www.associatedcontent.com/article/20644/a_brief_history_of_filesharing_from_pg2.html?cat=15 (last visited April 22, 2010).

²⁹¹ Eamon Forde *The Digital Decade* MUSIC WEEK, December 12, 2009.

²⁹² Knopper, *supra* note 92, at 183.

²⁹³ Mary Madden, *Artists, Musicians and the Internet* at 37, Pew Internet & American Life Project Dec. 5, 2004. Available at www.pewinternet.org (last visited April 22, 2010).

²⁹⁴ Patry, *supra* note 90, at 1. See also, Reidel, *supra* note 290.

²⁹⁵ Robert Kimball, *Testimony of Robert Kimball Senate Judiciary Committee Hearing on The Performance Rights Act and Parity Among Music Delivery Platforms*, August 4, 2009.

of 25-54 year olds listen to internet radio weekly.²⁹⁶ Data strongly suggests that internet radio and other authorized legal streaming mechanisms are replacing piracy and terrestrial radio as the preferred music listening process.²⁹⁷

Teenagers have long been a crucial demographic target for consumption. Use of internet radio among 13-17 year olds is on the rise. In 2007 only 34% of teenagers were listening to internet radio, but only one year later the percent increased to 52%.²⁹⁸ Accompanying the rise of teenager use of internet radio is the declining use of piracy facilitating technology. Among teenagers during the same time period, piracy through peer to peer downloading dropped by 6% and CD burning fell an estimated 28%.²⁹⁹ Similar trends are exhibited among other demographic groups.

Piracy is a global issue that is not limited to teenagers. Looking overseas, Spotify has gained great fanfare in Europe as a free on demand music streaming service. Launched in October of 2008, Spotify had more than 6 million users within its first year of operation.³⁰⁰ Rob Wells, senior Vice-President of digital music at Universal Music Group International, estimates that 60-80% of Spotify users in various European nations are former peer to peer music pirates.³⁰¹ Spotify has avoided launching in the U.S. due to higher royalty rates compared to those of Europe.³⁰² In its first year of operation, Spotify provided royalty income to copyright

²⁹⁶ *Id.*

²⁹⁷ Bridge Ratings, <http://www.bridgeratings.com/press.04.01.10.DeviceUsage.htm> (hourly terrestrial radio consumption declined by nearly 20% from 2005 to 2010) (last visited April 22, 2010).

²⁹⁸ Lee Graham, *Always a Bellwether for the Music Industry, Teens Are Changing How They Interact With Music* The NPD Group, March 31, 2009, available at http://www.npd.com/press/releases/press_090331a.html.

²⁹⁹ *Id.*

³⁰⁰ Antony Bruno, *Swimming Upstream* Billboard Magazine, December 19, 2009.

³⁰¹ *Id.*

³⁰² Michael Arrington, *Google and Spotify Dance Over U.S. Launch* Tech Crunch, Jan. 4, 2010, available at: <http://techcrunch.com/2010/01/04/google-spotify-launch-android-nexus-one/> (last visited April 22, 2010).

owners³⁰³ for the consumption of their music by up to 4.8 million people who used to steal their music. Internet radio currently provides sound recording owners with income they would otherwise be deprived of through common thievery.

Pandora is one of the great success stories in the internet radio community. Founded in 2000, Pandora began building the Music Genome Project.³⁰⁴ Developed by university trained musicologists, the genome consists of nearly 400 unique attributes that correspond to different elements of songs.³⁰⁵ Pandora categorizes music sharing common attributes and delivers them to end users as a personalized radio station.³⁰⁶ In 2008, Pandora had more than 15 million registered users who streamed personalized stations based upon a single artist or song that they are fans of.³⁰⁷ That number grew to surpass 27 million in 2009.³⁰⁸ Pandora will analyze any music that is delivered to them, and they will most often enter the music into the database, making it potentially retrievable by millions of people.³⁰⁹ According to Joe Kennedy, President and CEO of Pandora Media, Inc., of more than 60,000 artists whose music is in the Genome, 70% are not affiliated with a major record label, and more than 50% are independent musicians.³¹⁰ The high degree of independent musicianship on Pandora is common among other internet radio stations, and may be a major reason executives at the largest record labels share the

³⁰³ Robert Andrews, *Spotify's Mean Online Now Filling UK's CD Royalty Gap*, Paid Content:UK, March 14, 2010, available at <http://paidcontent.co.uk/article/419-spotifies-mean-online-now-filling-uks-cd-royalty-gap/>.

³⁰⁴ Pandora Corporate Information, <http://www.pandora.com/corporate/> (last visited April 22, 2010).

³⁰⁵ *Id.*

³⁰⁶ Joe Kennedy, Testimony of Joe Kennedy, President & CEO of Pandora Media, Inc. *Senate Judiciary Committee Hearing on Music and Radio in the 21st Century: Assuring Fair Rates and Rules Across Platforms*, July 29, 2008.

³⁰⁷ *Id.*

³⁰⁸ Meg Tirrell *Pandora Media Founder Sees Company's First Profit Next Year* Bloomberg, May 19, 2009, available at: <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aaKvHKT2hji0> (last visited April 22, 2010).

³⁰⁹ Joe Kennedy, *supra* note 306.

³¹⁰ *Id.*

anti-internet radio views of Edgar Bronfman Jr.³¹¹ When independent artists are played, larger companies don't get paid. Conglomerate copyright owners often view themselves as victims who are losing market share in the music industry each time independent distribution and promotion becomes easier for artists.³¹²

Pandora earned \$19 million in revenue during 2008, and estimated its revenue to reach \$40 million in 2009.³¹³ Under the 2009 royalty agreement between SoundExchange and large webcasters, Pandora's estimated 2009 minimum royalty payout was \$10 million.³¹⁴ More than 90% of Pandora's 2009 revenue came from advertising.³¹⁵ Pandora's revenue stream is typical for most internet radio services and advertisers continue to flock toward internet radio. During the first quarter of 2009, internet advertising revenue increased 13% while terrestrial network radio advertising revenue declined by 13%.³¹⁶ Advertisers pay substantial sums of money to have their advertisements played in-between streaming songs reaching millions of consumers. Users of the free Pandora service hear only two or three targeted 15-second commercials per hour.³¹⁷ Pandora founder Tom Westergren explains the effectiveness of Pandora's advertising. "We're not delivering an ad for a women's clothing store to men, or a bar or alcohol-related event to minors. Everything is delivered based on the information of the listener."³¹⁸ Pandora offers a \$3 monthly advertisement free subscription service, but has not attracted a large

³¹¹ Kimball, *supra* note 295 (stating "it is notable that the Association of American Independent Music applauds internet radio for playing more than 40% independent label music, compared to broadcast radio which plays less than 15% independent music.")

³¹² Patry, *supra* note 90, at xv ("Unless we recognize that the debates over copyright constitute an economic debate about business models, we will never be able to make the correct business and policy decisions.").

³¹³ Claire Cain Miller, *Music Labels Reach Online Royalty Deal*, New York Times, July 8, 2009.

³¹⁴ *Id.* (Pandora pays the greater of 25% revenue or a fee per listener stream. The calculation 25% of Pandora's estimated \$40 million 2009 revenue).

³¹⁵ *Services: Ad-funded Music Streaming's big Test*, MUSIC WEEK January 16, 2010.

³¹⁶ Joe Mandese, *Digital Radio Ad Spending Surges Amid Medium's Downturn*, Media Post News, May 22, 2009.

³¹⁷ Meg Tirrell *Pandora Media Founder Sees Company's First Profit Next Year* Bloomberg, May 19, 2009, available at: <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aaKvHKT2hji0> (last visited April 22, 2010).

³¹⁸ *Id.*

audience.³¹⁹ In the UK, roughly 5% of Spotify users pay a monthly fee of roughly \$14 (actual fee is £9.99 GBP) for advertisement free music.³²⁰ Currently there is an ongoing philosophical debate between recording company executives and internet radio companies regarding the perceived lost value of music when it is given away for free at greater access and more user control than exists with terrestrial radio.

Spotify CEO and co-founder Daniel Ek sees a shift in consumer desires. “There will always be a place for ownership, but as access to content improves, I think we’ll see many more people move toward this model. I love my vinyl and I love finding whatever I want to hear on my mobile. What’s important is giving fans the widest variety of choice.”³²¹ In the minds of the big four record companies, it often seems that no amount of royalty income obtained through internet radio will be enough until profits balloon to figures last seen in the 1990s.³²² David Ring, Vice President of business development and business affairs at Universal Music Group’s eLabs, told *Billboard Magazine* “I don’t think there’s enough value in that (ad-supported) business for anybody.”³²³ Like Warner Music Group, Universal shows a greater interest in licensing to subscription services. Ring continued, “We’re always trying to drive up-sell to transactions, up-sell to bundles and purchase. But we definitely are not looking at the hope and the prayer that giving away free streaming will somehow magically convert people into buyers.”³²⁴ Everyone likes free, consumers of music are no exception. The comments of David Ring and Edgar Bronfman Jr., appear to overlook the up-selling that comes with free internet radio.

³¹⁹ Music Week, *supra* note 315.

³²⁰ Ian Youngs, *Warner Quits Free Music Streaming*, BBC News Feb. 10, 2010.

³²¹ Forde, *supra* note 291.

³²² Knopper, *supra* note 92, at 170.

³²³ Bruno, *supra* note 300.

³²⁴ *Id.*

Most internet radio services offer direct links to purchase music, view album art, artist biographies, album reviews, and tour information.³²⁵ More music was purchased in 2008 than any year in history, and digital sales continue to replace physical music sales.³²⁶ With iTunes' current status as the largest music retailer,³²⁷ there is no denying that providing links to interact with and purchase music is beneficial to producing public performance and mechanical sales royalties for sound recording copyright owners. Apple, Inc. broadened its stake in the internet music market by purchasing Lala.com in December of 2009.³²⁸ Lala offers a unique hybrid business model compared to other music streaming services. The service will scan a user's computer for owned music and allow the user to listen to that music from any internet access point for free.³²⁹ Lala allows users to store their record collection in the great internet cloud, leaving the hard-drive behind. Individuals can listen to songs that have not been purchased one time for free. A web only license enabling unlimited internet listening can be purchased for \$0.10 per song, and a full purchase can be made for \$0.89 per song.³³⁰ Apple has taken an aggressive approach in growing Lala by making the acquisition price of songs generally lower on Lala than offered through the iTunes store.

During the first month Lala Launched its interactive service, 10% of users registered a credit card to facilitate music purchases.³³¹ Among these users, nearly 1 song was purchased for every 5 songs streamed.³³² Listeners of internet radio are directly connected to digital music stores and the websites of artists. This connectivity creates a two for one benefit for sound

³²⁵ Kimball, *supra* note 295.

³²⁶ IFPI, *supra* note 97, at 4.

³²⁷ *Id.* at 10.

³²⁸ Greg Sandoval, *Is Music Part of Apple's Tablet*, Cnet.com, January 26, 2010 available at <http://news.cnet.com/digital-media/?keyword=Lala> (last visited April 22, 2010).

³²⁹ Lala Help Information, <http://www.lala.com/#help> (last visited April 22, 2010).

³³⁰ *Id.*

³³¹ Bill Nguyen, *My Web Browser is My iPod*, Billboard Magazine, January 10, 2009.

³³² *Id.* (explaining 188 songs were purchased for every 1,000 new tracks played).

recording owners. Using Lala consumers as an example, it is conceivable that sound recording owners will be paid royalties for all audio streams, and receive a mechanical royalty for song sales an additional 20% of the time. A divergence of opinion exists between independent artists and large recording companies. Independent artists are finding more avenues to earn money and gain control over distribution of their music, while the major labels have experienced falling revenue and a loss of control over their traditional business model.

Traditionally, recording companies acted as gatekeepers of music distribution.³³³ Before the MP3, consumers of music traveled to brick and mortar music stores to acquire new music. Recording companies provided investment funding to promising artists in order to fund the \$1 it costs to manufacture a CD.³³⁴ Funding the manufacturing and shipment of physical albums was accompanied by a risk of oversupplying the market with goods that would not sell.³³⁵ The MP3 has provided society with a supply and demand risk-proof product. Because MP3's do not consume physical space, can be reproduced at minimal to no cost, and can be purchased from any location with an internet connection, little investment or risk accompanies the sale of MP3 music files.³³⁶ For recording companies, the shift from atoms technology to bits technology represents a loss of control, a changing of the guard with respect to old business models.³³⁷ Record companies grew accustomed to controlling access to terrestrial radio, access to record music stores, and access to home stereos. The DPRSRA and DMCA have created a scenario through which artists, sound recording copyright owners, and music consumers can all benefit in diverse ways from the existence of internet radio.

³³³ Knopper, *supra* note 92, at 33.

³³⁴ Cook, *supra* note 89.

³³⁵ Passman, *supra* note 52, at 71-72.

³³⁶ *Id.*

³³⁷ Patry, *supra* note 90.

Internet radio provides targeted audience advertising for musicians that simply cannot be obtained on terrestrial radio. Services that utilize technology similar to Pandora's Genome, deliver music that is directly tailored to a music listener's personal taste. Through a democratic process that allows listeners to approve or disapprove of streamed songs, the likelihood of a music purchase following a stream can be greatly increased.³³⁸ Internet radio stations commonly have 95% more songs in rotation than terrestrial radio, enabling more artists to be discovered and streamed to fans specifically seeking to hear similar music.³³⁹ Many services including Lala, Pandora, Blip, and Grooveshark allow listeners to share songs, playlists and stations with friends.³⁴⁰ The aforementioned sites allow listeners to publish a declaration of the music being consumed on social networking sites Facebook and Twitter. On demand service Grooveshark allows an entire playlist to be sent to friends. Unlike terrestrial radio, music broadcasted on the internet is more likely to reach a targeted buying audience and copyright owners are paid when their songs are played. The opportunity to be delivered music by unknown artists who match a listener's self described taste in music has increased the ease of discovering new artists. Social network publication of one's newly discovered music on Pandora or Grooveshark can result in a viral effect through which one's circle of peers start listening to and spending money on newly discovered musicians.

The phenomena of music consumers acting as disk jockeys, sharing newly discovered music with peers is replacing the tight control over broadcasting previously held by major recording companies with a people's democracy. Accompanying the democratic music movement is the opportunity for artists to circumvent costly terrestrial radio payola laws, to pay

³³⁸ Nguyen, *supra* note 331.

³³⁹ Kimball, *supra* note 295 (*explaining* traditional radio stations may only have 30 songs in regular rotation while an internet radio station may have more than 650 songs in rotation).

³⁴⁰ Nguyen, *supra* note 331.

for plays and exposure on internet radio. Last.FM and Jango.com are among several internet stations that allow bands to pay for song plays.³⁴¹ Through Last.FM, artists can buy 500 plays for \$100, 1,000 plays for \$200 and 2,000 plays for \$400.³⁴² According to one music executive, industry standard for fan acquisition cost is \$1 to \$2.³⁴³ The cost of paying for plays on targeted internet radio is within this reasonable spectrum when considering the interactive nature of internet radio listening. Last.FM even offers artists the ability to bypass SoundExchange and collect performance royalty payments directly from the webcasting service each time a song is played.³⁴⁴ Adding to the potential benefits, musicians can track useful consumer data through internet radio services. Grooveshark and others track listener trends and geographical locations of users.³⁴⁵ Musicians can use this data to target touring and promotion activities to those audiences proven to be drawn to their music.

Surprisingly, data regarding the music played through on demand services suggests that the fears of large labels are unfounded. Looking at the first six months of Spotify user data in the UK, approximately one billion songs were streamed to 2.7 million users.³⁴⁶ This is an average of 370 streams per user over six months. Of the 4.5 million songs available on Spotify's service, one third, or 1.5 million were never streamed.³⁴⁷ While users often exposed themselves to new music, the overwhelming choice was to listen to familiar songs whose sound recording copyrights are most often owned by recording labels. The top 100,000 songs played during the six months in question accounted for 80% of all streamed songs on Spotify.³⁴⁸ Copyright owners

³⁴¹ Glenn Peoples, *Does Payola Pay?*, Billboard Magazine, May 16, 2009.

³⁴² *Id.*

³⁴³ *Id.*

³⁴⁴ Last FM Upload Music <http://www.last.fm/uploadmusic> (when a play is paid for, the artist forgoes their royalty) (last visited April 22, 2010).

³⁴⁵ Nate Casey, *Viewpoint Nate Casey Co-Founder, Blazetrack.com* MUSIC WEEK January 16, 2010.

³⁴⁶ Eamonn Forde, *Trends: Spotify's Streaming Trends Uncovered* MUSIC WEEK, December 19, 2009.

³⁴⁷ *Id.*

³⁴⁸ *Id.*

may sense that they would earn more money through outright purchases of music than through streams. This is speculative however, because streaming royalties are the gift that keeps on giving each time a song is played. Recording companies and independent artists all stand to see regular royalty income delivered when their music is streamed. Because the listener has no financial risk of purchasing music they don't like, listener frequency to internet radio and thus royalty payouts can increase.

V. Conclusion: Where the Law Must Head

The laws overseeing internet radio are intended to control intellectual property. In the words of a Manhattan federal court, "Intellectual property regimes are economic legislation based on policy decisions that assign rights based on assessments of what legal rules will produce the greatest economic good for society as a whole."³⁴⁹ The rise of copyright law brought on by publishing, and the rise of music laws since the advent of the player piano demonstrate a natural order of events that helps to assure the greatest economic good for society is achieved through legislation. Ideally, the process begins with innovative technology affecting the ways in which intellectual property is distributed, consumed, or created. Businesses arise or shift their business models to exploit the new technology, creating implications for the creators and owners of intellectual property. Finally, the owners of the property seek new laws to restore balance and assure adequate compensation and limitations to the use of new technologies in distributing and reproducing their works. With internet radio law, the third step preceded the second one.

³⁴⁹ Patry, *supra* note 90, at xv (Citing, *Sarl Louis Feraud Int'l v. Viewfinder, Inc.*, 406 F. Supp. 2d 274, 281 (S.D.N.Y. 2005), affirmed on this point, vacated and remanded on other grounds, 489 F.3d 474, 480 n.3 (2d Cir. 2007).)

Since 1995, there have been adjustments to royalty rates and the methods of determining how these rates will be set and varied depending on the technology used. The key interests at stake are many. There are internet radio companies fighting for survival, and terrestrial radio stations who, through the representation of the NAB, have fought to suppress internet radio by adding costly royalty fees. Musicians have overwhelmingly supported internet radio as a new medium to interact with fans, while large recording companies continue to fight internet radio as the profits of the CD boom era drift further into the past. Finally, there are the interests of consumers. Those individuals who give music its monetary value³⁵⁰ have migrated in mass numbers toward the use of passive and interactive internet radio. By keeping royalty rates reasonable across all platforms, each of the five aforementioned interest groups can benefit from the growth of internet radio.

A. Shape Royalty Rates to Better Fulfill the Goals of the DPRSRA

Legislators, copyright owners, and the internet radio industry should seek to fulfill the articulated goal of the DPRSRA during future negotiations. As noted in section III, the DPRSRA seeks to (i) provide copyright owners with distribution control of their products through digital means (ii) without hurting the growth of new technologies and (iii) without imposing unreasonable burdens on broadcasters posing no threat to the distribution of sound recordings.³⁵¹ Some of these concerns have been answered by subsequent agreements and legislation, while others remain in need of adjustment.

Control for copyright owners under the DPRSRA should be narrowly interpreted as assuring the existence of anti-piracy mechanisms and delivery of royalties as well as streaming data. The DMCA added more assurances regarding piracy concerns and, under the most recent

³⁵⁰ *Id.* at xx.

³⁵¹ 65 Fed. Reg. 77,292 (Dec. 11, 2000) (citing S. REP. NO. 104-128, at 15 (1995)).

royalty agreement between webcasters and SoundExchange, there will be more substantial accounting and delivery of data regarding when and how songs are streamed.³⁵² To fulfill the second goal, royalty rates must be kept low enough to encourage market competition and innovation of technologies. If royalty rates grow too high, there is a detrimental risk of station consolidation similar to that seen after deregulation of terrestrial radio in 1996. Societal interests are better served by the fostering of arts that will continue to occur if more artists are broadcast to more listeners over internet pipelines.³⁵³ By continuing to require an annual per-station fee that counts toward royalty payment calculations, copyright owners are protected from an oversupply market that could devalue music. The per-station fee establishes a floor, assuring that new stations will cease to be founded if advertisement or subscription revenue cannot be realized to a level sufficient to pay the minimum annual fee.

A statutory rate should be applied to interactive streaming services. The rate should be slightly higher than that applied to passive streaming, because of the added control held by the listener and the possibility of displacing sales income. An absence of fair bargaining power exists currently where individual services are required to negotiate with copyright owners individually to establish royalty rates. The use of “most favored nations” clauses by record companies encourages copyright holders to refrain from engaging in meaningful bilateral negotiations with webcasters.³⁵⁴ SoundExchange can honor the desires of copyright owners who oppose interactive streaming by establishing an “opt-out” escape hatch for owners. SoundExchange should consider maintaining a two tiered catalogue of all sound recordings

³⁵² Claire Cain Miller, *Music Labels Reach Online Royalty Deal*, New York Times July 8, 2009.

³⁵³ Kimball, *supra* note 295.

³⁵⁴ *Supplemental Statement of Digital Media Association*, Senate Judiciary Committee Hearing on Music and Radio in the 21st Century: Assuring Fair Rates and Rules Across Platforms, July 29, 2009.

administered by the agency, to presume inclusion on interactive stations but allowing for owners to opt out.

B. Acknowledge The Fiction of a Willing-Buyer Willing-Seller Standard

Conceptually, the willing buyer-seller standard is worth seeking among rate-setters. In reality however, there are far more nuances to the market that make the concept pure fiction. The incentive for licensing exists through statutory regulations.³⁵⁵ Webcasters are forced to accept the rate set by the CRB or negotiate with SoundExchange. When a market has a single seller, there exists a unilateral market, not one consisting of willing buyers and sellers. It is essential for the improvement of future negotiations that legislators, the CRB, copyright owners and webcasters recognize the fiction of the willing buyer-seller standard.

The most recent negotiations between SoundExchange and webcasters demonstrate that bilateral talks can be successful. By achieving a more favorable rate than that produced by the CRB, the negotiations demonstrate that the CRB has continued a tradition started by CARP that subjectively favors the RIAA and large copyright owners when setting rates. The recent agreement is far from perfect. Webcasters have been forced to negotiate a blanket deal that may not adequately address the nuanced differences in business goals, models, and revenue streams. It must be recognized by the necessary parties that a willing buyer-seller standard cannot be formulated in a “one size fits all” form. Instead, the CRB, copyright owners and webcasters should exercise more flexibility in honoring the nuances of the internet radio market.

Flexibility should provide webcasters with additional options for determining how royalties will be computed. Parties should consider providing more options for large and small webcasters to choose a method of tabulating fees that works best with a webcaster’s business

³⁵⁵ *Id.*

model. SoundExchange should facilitate a program allowing sound recording copyright owners to accept one of three streaming royalty rates. By providing copyright owners the opportunity to charge a lower statutory fee for streaming their music, internet stations may be more likely to play less expensive artists. This in turn can foster creativity and competition among musicians, and enable independent or new artists the opportunity to generate more exposure. Those artists who are more established and wish to charge more for their music to be played will likely continue to be streamed frequently due to popular demand. Providing copyright owners and webcasters with pricing options will open up competition by encouraging experimentation with new business models. Pricing tiers can mitigate the current problem of SoundExchange acting as the unilateral seller in the market place of streaming music.

C. Address Payola as a Past and Future Concern

A future danger lurking in the shadows of internet radio, is the potential rise of payola on internet airways. The RIAA and NAB used their collective and questionable historical relationship to lobby Congress to pass the DPRSRA as a preemptive strike on internet radio.³⁵⁶ With the initial survival of internet radio, and its continued rise to replace terrestrial radio as the favored broadcast mechanism for hearing music, payola may find a home on internet radio. Currently, there is no legislation requiring disclosure when songs are paid to be played on internet radio and stations have taken advantage of this by allowing copyright owners to pay for exposure.³⁵⁷

One policy rationale behind terrestrial radio payola laws is to inform passive listeners when the music they hear is played based on sponsorship rather than the merits and quality of a

³⁵⁶ Spector, *supra* note 54, at 19-20 (2009).

³⁵⁷ Last FM, *supra* note 34 (when a play is paid for, the artist forgoes their royalty).

song or artist.³⁵⁸ This danger is mitigated on semi-interactive services where listeners have the power to skip a song. Legislators should consider extending disclosure requirements to internet radio to prevent wealthy copyright owners from squeezing independent musicians out of the market by outspending them by purchasing webcasting plays. Disclosure when payments are made should be required or payments should be outlawed entirely.

The risk of payola driven internet broadcasting is certain to grow as copyright owners continue to accept the internet as the world's preferred broadcast medium. If the current resistance to internet radio exhibited by the major record companies wanes, there might be an influx of spending by these companies as an attempt to exert influence and control over webcaster airwaves. Although conglomerate copyright owners have lost some control over the ways in which music is distributed, these companies still have more financial resources than independent musicians and recording labels. Warner Music Group and Universal Music Group could conceivably begin buying plays on Last.FM and other stations, to increase the exposure given to their sound recording copyrights. If this happens, the ills of payola on terrestrial radio will be replicated, including consolidated play lists and bribes. A mechanism must be put in place to prevent the corruption of internet radio and to preserve its presence as a democratic and merit based venue for music.

D. The Major Labels

Frustrations voiced by Edgar Bronfman Jr., and other major label executives are representative of the diminishing role of record companies as distributors of music. Distribution and supply of capital were the primary roles provided by recording companies throughout the

³⁵⁸ Katunich, *supra* note 130, at 647.

twentieth century.³⁵⁹ Internet radio is quickly becoming a primary distribution stream for music, and may one day become the primary way in which sound recording copyright owners earn royalty income. Services like Pandora, and the internet at large have made it significantly easier and less expensive for musicians to promote themselves and to develop careers without signing a traditional recording contract. The big four labels, Sony-BMG, EMI, Universal and Warner will continue to lose revenue and influence unless they take affirmative steps to provide consumers and musicians with the services they desire. Services provided should include non subscription internet radio.

Sony-BMG and Universal Music Group have invested millions of dollars in interactive subscription service MOG.com.³⁶⁰ MOG has licensing deals with all four of the major labels, and charges \$5 a month to subscribers.³⁶¹ The goal of up-selling content³⁶² will not provide an effective long term revenue stream so long as opportunities to listen to music exist where the royalty costs are paid for entirely by advertisers. If record company sentiment is that not enough royalty revenue is paid by legal internet radio stations, the record companies should compete and provide their own better stations. There are minimal content laws governing internet radio, any of the labels could host their own radio services online and charge outside advertisers to sponsor the stations. Record companies could then cut out the middle man, keep all advertisement revenue and increase the income derived from their own exploitation of owned sound recording copyrights.

³⁵⁹ Courtney Love, *Courtney Love Does the Math*, June 14, 2000, <http://www.salon.com/tech/feature/2000/06/14/love> (“Let’s not call the major labels ‘labels.’ Let’s call them by their real names: They are the distributors. They’re the only distributors and they exist because of scarcity. Artists pay 95% of whatever we make to gatekeepers because we used to need gatekeepers to get music heard.”) (last visited April 22, 2010).

³⁶⁰ <http://mog.com/about> (last visited April 22, 2010).

³⁶¹ <http://www.wired.com/epicenter/2009/10/mogs-5-per-month-music-service-highlights-spotify-obstacles/> (last visited April 22, 2010).

³⁶² Bruno, *supra* note 300.

If Edgar Bronfman Jr. were to lead the fight against internet radio by refusing to license Warner Music Group's music to interactive non-subscription services, musicians on his label would lose out. With more than 69 million Americans listening to internet radio on a regular basis,³⁶³ Warner Music Group would likely be pressured to issue licenses and rejoin the world of internet radio due to lost royalty profits and pressure from their own content producers, the musicians. Music is made to be listened to, and recording companies exist primarily to deliver music and fund its creation. Record labels should experiment more actively with free internet radio options, because they produce revenue that can be used to fund music creation, and provide an inexpensive distribution stream to target audiences.

E. A Final Word

Copyright law can be traced as far back as Ancient Greece. As societies grow and technologies are invented, the law and industry adjust to accept or reject new technologies. Determinations should be made in favor of providing the greatest benefit to society as a whole.³⁶⁴ Although it can take substantial time, eventually harmony is reached between the law, content providers, content distributors, and consumers. Since the DPRSRA was passed in 1995, there has been a steady march to seek harmony among these parties so that internet radio can exist as a viable business and service to all of society's music creators owners and consumers. The 2009 negotiations between SoundExchange and webcasters represent a breakthrough toward harmony of law.

³⁶³ Kimball, *supra* note 295.

³⁶⁴ Patry, *supra* note 90, at xv (*Citing*, *Sarl Louis Feraud Int'l v. Viewfinder, Inc.*, 406 F. Supp. 2d 274, 281 (S.D.N.Y. 2005), affirmed on this point, vacated and remanded on other grounds, 489 F.3d 474, 480 n.3 (2d Cir. 2007)).

Today the debate over internet radio can be framed as a philosophical one. Society must determine whether music loses “value” when it is given away for free at greater access and with more user control than exists with terrestrial radio. I believe the answer is no, music does not lose value in the context of free internet radio. Sound recording and composition copyright owners receive a steady stream of royalty income from internet radio. It should not matter if revenue is paid for by advertisers or consumers of music, so long as a sustainable income is obtained by creative entities and distributive businesses. The RIAA and major record companies, together with the NAB and terrestrial broadcasters, must accept that internet radio is here to stay. Musicians and consumers have demonstrated their desire for this technology. Consumers have demonstrated a willingness to receive advertisements or pay modest subscriptions as a means to recognize value of the music they hear. Industry battles over copyright schemes are based on changes in technology and business models.³⁶⁵ Now it is up to the RIA and NAB to adjust their models so as to remain relevant and successful in the coming decades.

³⁶⁵ William Patry, *MORAL PANICS AND THE COPYRIGHT WARS* xv(Oxford University Press 2009).